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IN THE

Supreme Court of the State of Delaware

IN RE ZIMMER BIOMET HOLDINGS, INC. DERIVATIVE LITIGATION

No. 304, 2021

CASE BELOW:

COURT OF CHANCERY OF THE STATE OF DELAWARE,
C.A. No. 2019-0455-LWW

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APPELLEES' ANSWERING BRIEF ON APPEAL

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NATURE OF PROCEEDINGS[1]

This is an appeal from the dismissal on demand futility grounds of a stockholder derivative complaint purportedly filed on behalf of Zimmer Biomet Holdings, Inc. ("Zimmer" or the "Company"), a publicly-traded medical device manufacturer headquartered in Warsaw, Indiana, and incorporated in Delaware. This case involves derivative claims against certain of Zimmer's current and former officers and directors, as well as private equity funds who had invested in the Company through its 2015 merger with Biomet (the "Merger"). The claims of Plaintiffs-Appellants ("Plaintiffs") are based on the theory that Zimmer's Board of Directors ("Board") knew about Food & Drug Administration ("FDA") compliance issues at one of Zimmer's medical device manufacturing facilities and knew that these issues would negatively impact Zimmer's financial performance.

[1] Citations to Plaintiffs-Appellants' Appendix are in the form of "A###." Citations to "¶__" refer to the numbered paragraphs of the Complaint which can be found in the Plaintiffs-Appellants' Appendix at A62-212. Citations to Appellants' Corrected Opening Brief ("ACOB") (Trans. ID 67093638) are in the form of "ACOB" followed by a period and the page number. Citations to the Court of Chancery's Opinion are in the form "Op." with the page number following the period. Citations to Defendants-Appellees' Appendix are in the form of "B##." Internal citations are omitted, and emphasis is omitted/added unless otherwise stated.

In September 2016, the FDA commenced an inspection of a Zimmer facility located in Warsaw, Indiana, known as North Campus.[2] The inspection led to unanticipated product holds, manufacturing shutdowns and remediation efforts that cost money and affected Zimmer's revenue growth rate. In subsequent correspondence with the FDA, Zimmer explained that its corporate management team identified problems at North Campus based on three internal audits in the first half of 2016, that the FDA's inspection identified some of the same issues, and that even prior to the FDA inspection, Zimmer had started to remediate those problems.[3] The Board, while aware of Zimmer's internal auditing and remediation efforts at various plants, was not provided the details of those North Campus audits, much less advised that the audit findings would necessitate product holds or manufacturing disruption, which were among the reasons the Company ultimately lowered its fourth quarter guidance.[4]

After Zimmer announced its third quarter results (which were disappointing for unrelated reasons) and reduced its guidance, its stock price dropped. A putative class action (the "Securities Action") followed, alleging violations of the federal

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[2] Zimmer has two facilities in Warsaw, Indiana. "North Campus" is a legacy Biomet facility. The other Warsaw facility is a legacy Zimmer site referred to as "Warsaw West" or "West Campus."

[3] A788-95.

[4] *See infra* Facts §§C-D.

securities laws against Zimmer, certain of its current and former officers and directors, and private equity investors who sold stock in three offerings earlier in 2016 (the "Offerings").

Plaintiffs here received documents through various 8 *Del. C.* §220 ("Section 220") demands and commenced this derivative litigation. Plaintiffs' Verified Consolidated Stockholder Derivative Complaint ("Complaint")[5] contains six causes of action that fall into two groups: first—disclosure based claims—that the Board knew about the severity and financial impact of the FDA quality systems problems, yet failed to disclose them to investors;[6] and, second—insider trading based claims—that the Company's private equity investors knew about the problems too and engaged in insider trading by selling their stock in the Offerings before the problems were made public.[7]

Defendants moved to dismiss the Complaint for failure to plead demand futility with particularity pursuant to Ch. Ct. Rule 23.1 ("Rule 23.1") and for failure to state a claim pursuant to Ch. Ct. Rule 12(b)(6) ("Rule 12(b)(6)"). The

[5] A62-212.
[6] Counts I (¶¶335-39, ¶¶341-42), III (¶¶349-56), V (¶¶364-66, ¶¶368-69).
[7] Counts I (¶¶335-37, ¶¶340-42), II (¶¶343-48), IV (¶¶357-63), V (¶¶364-69), VI (¶¶370-79).

Court of Chancery granted the motion pursuant to Rule 23.1 and dismissed the Complaint.

The parties and the Court below agree on the standard for determining demand futility: whether Plaintiffs have sufficiently pled that a majority of the Zimmer board, as constituted at the time of the Complaint (the "Demand Board") faces a substantial likelihood of personal liability. Because Zimmer's Certificate of Incorporation contains an exculpation provision, this requires that Plaintiffs plead particularized facts showing knowing or bad faith conduct that rises to a breach of the duty of loyalty.

For the disclosure claims, the question turns on whether the Demand Board knew about the quality systems issues at North Campus and knew that these issues would have a negative, material financial impact on the Company. Plaintiffs assert that they have met this standard because the court in the Securities Action found that knowledge had been adequately alleged based on the facts pled in that case, and here Plaintiffs have those same facts, plus facts based on documents received through a Section 220 demand. As the Court of Chancery found, however, the relevant Securities Action decision addressed the alleged knowledge of Zimmer officers against whom scienter-based claims were asserted, but said nothing about ***the Board's*** knowledge. Nor do the Section 220 documents reveal Board

knowledge. They do not include any substantive description of North Campus audits, and they say nothing about the impact of future FDA inspections, future product holds, or the resulting impact on the Company's financials. The Court of Chancery also correctly ruled that Plaintiffs failed to plead Board-level involvement in the challenged statements.

As to the "insider trading" claims, they are based on pre-announced sales of stock by private equity funds who had invested in Biomet ("PE Funds"), transparently conducted through SEC-registered secondary offerings. The touchstones of this claim as they relate to Rule 23.1 are straightforward:

- First, ***none*** of the Demand Board's directors personally sold stock in the relevant Offerings.
- Second, ***only one*** director is alleged to have personally benefited from the sales through his affiliation with a PE Fund.
- Third, Plaintiffs ***do not allege*** that this one director or the PE Funds controlled a majority of the rest of the Demand Board.
- Fourth, as it relates to the Securities Action, the insider trading claims against the PE Funds were ***dismissed*** for failure to allege that the PE Funds possessed material nonpublic information.

Finally, Plaintiffs cannot save their demand futility argument for the insider trading claims under the theory that the other Demand Board members "knowingly facilitated" the sales because (even if this was a recognized avenue to plead

demand futility, which it is not) there are no facts suggesting the directors knew that the PE Funds were engaged in insider trading.

For these reasons, this Court should affirm the Court of Chancery's dismissal of the Complaint under Rule 23.1.

APPELLEES' ANSWER TO APPELLANTS' SUMMARY OF ARGUMENT

1. Defendants-Appellees ("Defendants") deny Paragraph 1 of the Summary of Argument presented by Plaintiffs.[8] The Court of Chancery properly formulated and applied the correct legal standard for testing whether a majority of the Demand Board faced a substantial likelihood of liability for the disclosure claims here. To allege a non-exculpated disclosure claim when no shareholder action was requested, Plaintiffs must allege scienter and Board-level involvement in the allegedly false statements. To plead scienter, Plaintiffs must allege particularized facts showing that the directors knew that disclosures or omissions were false or misleading or acted in bad faith not adequately informing themselves. The Court of Chancery appropriately applied these standards and concluded that Plaintiffs failed to plead demand futility. The Court of Chancery also correctly ruled that Plaintiffs failed to plead Board-level involvement in the challenged statements.

2. Defendants deny Paragraph 2 of Plaintiffs' Summary of Argument.[9] The Court of Chancery should be affirmed because Plaintiffs' insider trading claims affect only one director, not a majority of the Demand Board. Plaintiffs

[8] ACOB.7.
[9] ACOB.7.

contend that a majority of the Demand Board is liable for knowingly facilitating the stock sales by approving the Offerings, but this theory does not suffice to plead a breach of fiduciary duty claim without a disclosure violation or personal benefit. Even if this theory were viable, the Court of Chancery correctly found that Plaintiffs lack particularized facts showing that material non-public information was shared with the PE Funds, that this information formed the basis of the PE Funds' stock sales, or that a majority of the Demand Board knew either of these purported facts.

STATEMENT OF FACTS

A. Defendants.

The chart below summarizes the Defendants named in the Complaint filed on June 14, 2019[10]:

Demand Board	**Former Directors**	**Officers**	**PE Funds**
Christopher B. Begley	Paul M. Bisaro	David C. Dvorak	Blackstone
Betsy J. Bernard	Cecil B. Pickett	Daniel P. Florin	Goldman
Gail K. Boudreux	Jeffrey K. Rhodes		KKR
Michael J. Farrell			TPG
Larry C. Glasscock			
Robert A. Hagemann			
Arthur J. Higgins			
Michael W. Michelson			
Brian Hanson*			
Maria Hilado*			
Syed Jafry*			

*Denotes Demand Board members ***not*** named as defendants. The "Director Defendants" consist of eight Demand Board members (Begley, Bernard,

[10] ¶¶35-45, 294; ¶¶48-63. The entities comprising the different PE Funds are listed in ¶48 ("Blackstone"), ¶52 ("Goldman"), ¶56 ("KKR") and ¶59 ("TPG").

Boudreux, Farrell, Glasscock, Hagemann, Higgins, and Michelson) and three former Board members: Bisaro, Pickett, and Rhodes.

The Demand Board has eleven members, so for Plaintiffs to plead demand futility as to a majority, it must do so for six directors.

B. Stockholders Agreement And 2016 Offerings.

In connection with the Merger, Zimmer entered into a stockholders agreement (the "Stockholders Agreement") with legacy Biomet's holding company, through which the PE Funds then held their Biomet stock.[11] The Stockholders Agreement was a publicly disclosed document that required that Zimmer file and maintain a registration statement with the SEC and allowed the PE Funds to sell their eventual Zimmer holdings in future public offerings.[12]

On February 4, 2016, in accordance with the Stockholders Agreement, Zimmer filed a shelf registration statement, and three public offerings followed.[13] First, on February 10, 2016, Blackstone sold all and Goldman sold approximately half of their Zimmer holdings (the "February Offering").[14] Second, on June 13, 2016, Goldman sold its remaining shares, and TPG and KKR each sold approximately half of their investment (the "June Offering").[15] Finally, on August

[11] ¶¶4 n.1,5; B21
[12] ¶¶5, 85; A448-450, §4.3.
[13] A487-533.
[14] ¶¶50, 54, 261.
[15] ¶¶54, 56, 61, 262.

9, 2016, TPG and KKR sold their remaining shares (the "August Offering," collectively with the February and June Offerings, the "Offerings").[16] None of Zimmer's directors sold stock in the Offerings.

For each of the Offerings, Zimmer was required to file prospectuses outlining the structure of the deals. None of the Director Defendants signed these prospectuses.[17] Moreover, none of the Offerings required Zimmer or the Director Defendants to waive any lockup provisions to allow the PE Funds to sell their shares. The Court of Chancery noted that the lockup provision relating to the June 2016 offering did preclude additional sales within 60 days, which affected the August Offering, but that lockup could only be waived by the underwriters, "Goldman, Sachs & Co. and J.P. Morgan Securities LLC."[18]

Pursuant to the Stockholders Agreement, the PE Funds appointed two members of Zimmer's Board who had previously served on Biomet's Board: Michelson (from KKR) and Rhodes (from TPG).[19] The PE Funds were entitled to certain confidential information, provided they comply with confidentiality restrictions and maintain "***adequate procedures to prevent such information from***

[16] ¶¶56, 61, 264.
[17] Op.39 n.182.
[18] Op.57 n.250.
[19] ¶¶42, 45, 85, 87; B31.

being used in connection with the purchase or sale of securities of the Company in violation of Applicable Law."[20] The Stockholders Agreement also prohibited directors from breaching their fiduciary duties.[21]

C. The Board Was Regularly Informed Of Zimmer's Normal Course Efforts To Meet Its Quality Systems Compliance Obligations.

As shown in the Board meeting minutes and presentations identified in the Complaint, which Plaintiffs received through a Section 220 demand, the Zimmer Board was regularly updated on quality systems compliance at Zimmer facilities and the progress being made with respect to issues requiring remediation.[22] Indeed, at every regular meeting, the Board received a 20-to-30 minute presentation titled, "FDA and Quality Matters."[23]

The presentation typically began with an "FDA Update" containing information on FDA inspection results and communications, and the Company's remediation efforts. Plaintiffs do not dispute that the Board materials show that Zimmer was successfully remediating issues at various facilities worldwide and successfully responding to concerns the FDA expressed during inspections.[24]

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[20] A435-437, §1.6.
[21] ¶86; A437, §1.6(b).
[22] A534-746.
[23] *Id.*
[24] ¶¶126-94.

These successful remediation efforts included, among other locations, Zimmer's facilities in Jinhua, China; Ponce, Puerto Rico; and Warsaw, Indiana West Campus.[25]

The presentations next generally discussed other "Quality Matters" relating to Zimmer's internal quality systems auditing process, which relied on teams of Zimmer auditors and third-party auditors from companies like Parexel and Dohmen Life Sciences Services.[26] This is no surprise; the FDA expects medical device manufacturers to self-identify problems and try to fix them, and it grades companies on the strength of those Corrective and Preventative Action ("CAPA") programs.[27] One of Zimmer's programs involved a plan to audit legacy Biomet facilities, including North Campus.[28]

Zimmer conducted the North Campus audits in the first half of 2016.[29] ***Plaintiffs do not and cannot allege that the full audit reports, or even a description of the compliance issues they addressed, were shared with the Board.*** From all of the Board materials produced and identified in the Complaint (including materials from more than 10 Board meetings from 2015-2016),

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[25] A534-746.
[26] ¶¶126-94; Op.9-14; ACOB.14.
[27] ¶96.
[28] A629-30, A634 (cited ¶¶153-55).
[29] ¶¶122, 124.

Plaintiffs point to a single slide from the May 3, 2016 FDA and Quality Matters presentation that mentions the internal audits at North Campus, and alleges based on that single slide reference that the Board had knowledge of serious compliance issues at this facility.[30] The full slide from the Complaint, which highlights in red boxes those audits that Plaintiffs assert, on information and belief, correspond to the three North Campus internal audits,[31] is reproduced here:

The top highlighted line refers to an "EtQ Complaints Enterprise Audit - Multiple sites," with the specific location listed as "N/A," and makes no reference to North

[30] ACOB.14.
[31] ¶159 & n.18.

Campus.[32] The bottom line similarly refers to a "N/A" location and describes a general Corporate Audit Process, with the report still in draft form. Only the middle highlighted line refers to an audit at North Campus.[33] While the audit results are provided ("4 critical, 15 major"), these are not significantly different from the other audit results on this slide (*e.g.*, the "1 critical, 10 major and 3 minor" listed for an audit in Jinhua, China).[34] There is no description of the issues identified by the auditors.[35]

The Board next met on July 15, 2016. The presentation at that meeting included the following slide about remediation efforts and internal audits: [36]

[32] A658 (cited ¶159).
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] A695 (cited ¶166).

There is no information on this slide about specific internal audits of North Campus and no indication of any potential for adverse outcomes relating to any audits. Instead, the slide refers to ongoing corporate audits meant to "identify opportunity areas prior to FDA inspections."[37] It does not state that these audits relate to the three internal audit reports analyzing the North Campus facility. The presentation includes no other information relating to any other audits nor does it mention any potential for severe financial outcomes relating to any audits.

[37] *Id.*

D. The Board Was Not Presented With Any "Red Flags."

Although the Complaint discusses each Board and Audit Committee meeting in 2015-2016, and what it frames as "disastrous" results following FDA inspections,[38] there are no allegations that any information was presented to the Board suggesting:

- That Zimmer was manufacturing or shipping products that were unsafe to use.
- That any compliance issues resulted or would result in product holds at any Zimmer facility.
- That any past remediation efforts or compliance issues had affected or would negatively affect Zimmer's growth rate.

Moreover, the Complaint does not allege that the information provided to the Board about compliance issues even referenced Zimmer's growth rate or revenue goals.[39] In fact, Zimmer beat revenue expectations in the first two quarters of 2016.[40] The Complaint also does not identify anyone telling the Board that compliance issues were "systemic," that they could not be remediated in a timely manner, or that they would impact the Company's financial performance.

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[38] ¶¶269, 270.
[39] ACOB.14-15 (claiming by June and August Offerings, directors knew Zimmer could not accelerate growth while remediating compliance concerns).
[40] ¶¶202, 204.

E. The September 2016 FDA Inspection At North Campus.

Based on the 2016 internal audits, Zimmer began remediation efforts to address the compliance observations.[41] On September 12, 2016, before the Company could implement the full scope of its remediation work, the FDA initiated an inspection at North Campus.[42] The Board learned of this "unannounced inspection" at a September 23, 2016 meeting.[43] On Thursday, September 29, 2016, while the FDA's inspection was ongoing, Zimmer proactively and voluntarily instituted product holds at North Campus to address initial concerns raised by the FDA.[44] The Company's third quarter ended the next day: Friday, September 30, 2016. These product holds began to be released on October 21, 2016.[45] Plaintiffs highlight that the FDA inspection was "for cause," allegedly prompted by complaints about quality control violations that "endangered public safety," but they identify no instance of anyone being harmed by or even receiving purportedly unsafe products manufactured at North Campus.[46] Nor do they

[41] A789 (cited ¶¶124, 159 n.18).
[42] ¶113.
[43] A718-20 (cited ¶174 n.21).
[44] A789 (cited ¶124); *see also* ¶¶114, 115.
[45] ¶115.
[46] ACOB.1-2, 16-17.

provide facts showing that the violations the FDA found at North Campus corresponded to the "complaints" prompting the "for cause" inspection.[47]

On October 24, 2016, the Audit Committee, joined by Zimmer officers, Zimmer counsel and Zimmer's external auditor, met to discuss the FDA inspection at North Campus and the contents of the draft earnings release. The Audit Committee discussed how the earning results had been completed and reviewed by the Company's auditor and by inside and outside counsel.[48]

On October 31, 2016, Zimmer announced less-than-expected third quarter results due to merger-related supply chain integration issues (unrelated to the FDA inspection), and that it was lowering its fourth quarter guidance.[49] Zimmer's stock price fell.[50] On November 8, there was an analyst report and further announcements by Zimmer that disclosed the shutdown and that the impact from the shutdown was included in its already-reduced guidance.[51] Zimmer's stock price fell again.[52]

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[47] ACOB.16-17; ¶¶113-14.
[48] A801 (cited ¶181).
[49] ¶217.
[50] ¶217.
[51] Op.19-20; ¶¶220-22.
[52] ¶223.

On November 22, 2016, the FDA issued a Form 483 relating to its unannounced inspection of North Campus.[53] On December 14, 2016, Zimmer issued a press release noting that it was developing and executing a remediation plan to address the issues cited by the FDA.[54] Zimmer further explained that it was addressing compliance gaps at North Campus, and re-confirmed that its earnings guidance update issued on October 31, 2016 included the potential impact from the North Campus inspection.[55]

On December 21, 2016, the Company provided its initial response to the FDA.[56] In that response, Zimmer explained (1) that its corporate management team had been aware of certain problems at North Campus based on three internal audits in the first half of 2016, which identified some of the issues that concerned the FDA, and (2) that prior to the FDA inspection, Zimmer had started to remediate those problems.[57] The Board continued to receive updates about the North Campus inspection and response throughout 2017 and 2018.[58] The

[53] ¶20.
[54] Op.21-22.
[55] Op.22.
[56] ¶21.
[57] A788-95.
[58] ¶¶189-94.

estimated cost for remediating North Campus was not provided to the Board until May 2017.[59]

F. The Challenged Statements.

Zimmer's public SEC filings informed investors of the FDA's quality systems regulations and monitoring and did not guarantee that all of its facilities were at all times in full compliance with all FDA regulations.[60] Before (and after) the North Campus inspection, Zimmer regularly disclosed to investors when the FDA issued warning letters and Form 483s following inspections at various facilities.[61]

In their Complaint, Plaintiffs challenge certain SEC filings, including Zimmer's 10-K filed on February 29, 2016; 10-Q's filed on May 10, 2016, August 8, 2016 and November 8, 2016; and additional SEC filings relating to the Offerings, as well as statements by Zimmer Officers in various contexts, several of which were oral.[62] The Director Defendants had no role in these oral statements, nor did they sign the Form 10-Q filings or the preliminary and final prospectuses.[63]

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[59] ¶190.
[60] B4 (stating that Zimmer is subject to FDA review "which may result in observations on Form 483, and in some cases warning letters, that require corrective action, or other forms of enforcement").
[61] *See, e.g.*, B1-35; A427-533.
[62] ¶¶199-203, ¶¶205-10, ¶215, ¶¶218-19, ¶221.
[63] Op.46-47.

Specifically, Plaintiffs claim that "[t]he Individual Defendants…conceal[ed] the systemic quality system and quality control problems and FDA regulatory deficiencies by allowing the Company to issue materially false and misleading statements and omissions about the purported successful integration and the Company's growing organic growth rate."[64]

G. The Securities Action.

A putative class action, *Shah v. Zimmer Biomet Holdings, Inc.*, 3:16-cv-00815) (the "Securities Action" or "*Shah*"), was filed in the Northern District of Indiana on December 2, 2016, asserting claims for purported violations of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[65]

The federal court denied in part the motion to dismiss the Securities Action, finding that scienter was adequately pled as to Zimmer and the Zimmer officer defendants for the Exchange Act claims.[66] The federal court also denied the motion to dismiss the Securities Act claims asserted against eight of eleven members of the Demand Board based on statements in documents related to the

[64] ¶195.
[65] ¶¶279, 281.
[66] ¶283 (citing *Shah v. Zimmer Biomet Holdings, Inc.*, 348 F. Supp. 3d 821 (N.D. Ind. 2018).

June and August Offerings. These claims did not involve any analysis of the Director Defendants' state of mind because *scienter* was not an element of the claims against them.[67]

The federal court granted the motion to dismiss the claims against the PE Funds who sold shares in the June and August Offerings.[68] The claims for violations of the Securities Act were dismissed because the PE Funds were not statutory sellers.[69] The insider trading claims under the Exchange Act were dismissed because plaintiffs failed to allege any information that was shared with the PE Funds that provided them with knowledge of material inside information. Rather, plaintiffs had "alleged nothing more than that [certain of] the [PE] Defendants had *potential* access to insider information."[70] *Shah* subsequently settled with no contribution from any Director Defendant or PE Fund.[71]

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[67] *Shah*, 348 F. Supp. 3d at 847.
[68] The Blackstone Defendants, all of whom sold their shares in the February Offering, were not named as defendants in *Shah*.
[69] *Id.* at 848.
[70] *Id.* at 849.
[71] ¶28.

ARGUMENT

A. The Court Of Chancery Properly Found That Demand Was Not Excused.

1. Question Presented

Did the Court of Chancery correctly find that pre-suit demand under Rule 23.1 was not excused because Plaintiffs failed to plead particularized facts showing that a majority of Demand Board directors faced a substantial likelihood of liability for a non-exculpated claim for a breach of the duty of loyalty?[72]

2. Scope Of Review

The Supreme Court's "review of decisions of the Court of Chancery applying Rule 23.1 is *de novo* and plenary."[73]

3. Merits Of Argument

a. Legal Standard For Whether Pre-Suit Demand Is Excused

The parties agree and the Court of Chancery properly found that the test for whether pre-suit demand is excused here is whether Plaintiffs sufficiently pled that a majority of the Demand Board faces a substantial likelihood of liability for

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[72] Issue preserved below, *see* B74-77, B123-24, B165-67, B196-97, B227-28.
[73] *United Food & Commercial Workers Union and Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 2021 WL 4344361, at *6 (Del. Sept. 23, 2021) (quoting *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000)). Plaintiffs do not contend that a majority of the Demand Board lacked independence or received a material personal benefit from the alleged misconduct, nor do they argue a *Caremark* claim.

breach of fiduciary duty.[74] This is consistent with the test as recently set forth by this Court in *Zuckerberg*.[75]

Where, as here, the Company's Certificate of Incorporation has a provision pursuant to 8 *Del. C.* §102(b)(7) exculpating the Company's directors from personal liability for any breach of the duty of care,[76] Plaintiffs must allege a breach of the duty of loyalty.[77] As the Complaint recognizes, pleading a breach of the duty of loyalty requires allegations showing knowing or bad faith conduct; in other words, scienter on the part of a majority of the Demand Board.[78] These allegations must be supported with particularized facts, not conclusory statements.[79]

The Court must (and did) accept all well-pleaded allegations as true and draw all reasonable inferences in the plaintiff's favor.[80] The Court must not, however, "credit conclusory allegations that are not supported by specific facts, or

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[74] *See* Op.2, 25-27; ACOB.4-5, 7, 24-25 ("the Court below . . . identified the proper inquiry on demand futility").
[75] 2021 WL 4344361, at *17.
[76] B43.
[77] Op.28, 31-32; *In re GoPro, Inc. S'holder Deriv. Litig.*, 2020 WL 2036602, at *12 (Del. Ch. Apr. 28, 2020).
[78] *See, e.g.*, ¶26, ¶303, ¶338 (pleading breach of fiduciary duty claims arising from "knowing, disloyal and/or bad faith acts and omissions").
[79] Op.31-32; *accord Wood v. Baum*, 953 A.2d 136, 141 (Del. 2008); *City of Birmingham Ret. & Relief Sys. v. Good*, 177 A.3d 47, 55 (Del. 2017)
[80] *Norton v. K-Sea Transp. P'rs L.P.*, 67 A.3d 354, 360 (Del. 2013).

draw unreasonable inferences in the plaintiff's favor."[81] And a complaint may be dismissed where the unambiguous language of the documents on which it relies negate the complaint's allegations.[82]

Plaintiffs' argument that the "Court[] fail[ed] at every step to extend reasonable inferences solely in favor of Plaintiffs" and did not address whether Plaintiffs had pled a "reasonable doubt" as to the relevant directors' interestedness amounts to nothing more than a disagreement with the Court of Chancery's conclusions.[83] The Court of Chancery ***did*** analyze whether the Complaint "create[s] a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[84] Plaintiffs' curious reliance on the definition of "reasonable doubt" in criminal matters to further their argument[85] does not show that the Court of Chancery misapplied the standard or failed to draw

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[81] *Id.*
[82] *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001) ("[A] claim may be dismissed if allegations in the complaint or in the exhibits incorporated into the complaint effectively negate the claim as a matter of law."); *In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022, 1026 (Del. Ch. 2012) ("Having premised their recitation of the facts squarely on that document and incorporated it, the plaintiffs cannot fairly, even at the pleading stage, try to have the court draw inferences in their favor that contradict that document.").
[83] ACOB.25-27.
[84] Op.26 (quoting *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)).
[85] ACOB.26-27 (citing *Mills v. State*, 732 A.2d 845, 851 (Del. 1999)).

inferences in favor of Plaintiffs.[86] Rather, the Court of Chancery's conclusion demonstrates faithful application of the pleading standards, which hold that "Rule 23.1 is not satisfied by conclusory statements or mere notice pleading."[87]

b. The Court of Chancery Properly Set Forth And Applied The Correct Legal Standard For The Disclosure Claims.

The Court of Chancery correctly set forth the two relevant requirements for alleging a non-exculpated disclosure claim: (1) particularized allegations that "directors 'had knowledge that any disclosures or omissions were false or misleading or . . . acted in bad faith in not adequately informing themselves'" (*scienter*),[88] and (2) "'sufficient board involvement in the preparation of the disclosures' to 'connect the board to the challenged statements'" (*board involvement*).[89]

(1) The Court Of Chancery Properly Found That The Complaint Did Not Adequately Plead Scienter.

Recognizing that Plaintiffs "lack[ed] any obvious motivations" for the independent directors "to act disloyally," the Court of Chancery appropriately

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[86] ACOB.25-26.
[87] Op.26 (quoting *Brehm*, 746 A.2d at 254).
[88] Op.32 (quoting *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 134 (Del. Ch. 2009)); *accord Fisher ex rel. LendingClub Corp. v. Sanborn*, 2021 WL 1197577, at *17 (Del. Ch. Mar. 30, 2021); *Steinberg ex rel. Hortonworks, Inc. v. Bearden*, 2018 WL 2434558, at *9-11 (Del. Ch. May 30, 2018).
[89] Op.32 (quoting, *inter alia*, *CitiGroup*, 964 A.2d at 134 and *In re TrueCar, Inc. S'holder Deriv. Litig.*, 2020 WL 5816761, at *13 (Del. Ch. Sept. 30, 2020)).

focused its scienter inquiry on what Plaintiffs allege the Demand Board was told about the regulatory problems with North Campus and the effect of these problems on Zimmer's financial performance.[90] The Court of Chancery examined three time periods[91] and looked for information telling the Board that – as pled in the Complaint – North Campus "was in a terrible state of FDA compliance[,]" a "disaster waiting to happen[,]"[92] or that – as argued by Plaintiffs on appeal – "*identified the very problems that caused the shutdown*."[93] It found none.

The Court of Chancery concluded that before May 3, 2016, the Board presentations "contain only limited and unremarkable mentions of the North Campus," such as being told that (1) North Campus had been inspected in 2014 resulting in two negative observations, (2) it was due for its biennial FDA inspection in 2016, and (3) a mock inspection by an outside consulting firm identified 11 major and 7 minor observations that Zimmer was in the process of addressing.[94] Plaintiffs did not plead, and so the Court of Chancery did not reference, that the Board knew anything about the North Campus internal audits before the 2015 10-K or February Offering, nor could they have because the first audit report was not issued until after

[90] Op.32, 34.
[91] Op.34-36, 40-43, 45-47.
[92] Op.40 (quoting ¶13; ¶125).
[93] ACOB.35.
[94] Op.35.

they occurred. Plaintiffs' Brief does not challenge these conclusions by the Court of Chancery.

The Court of Chancery then carefully analyzed two presentations in 2016 that Plaintiffs highlighted in their Complaint.[95] First, the Opinion reviewed the slide from the May 3, 2016 Board presentation identifying audits at 14 Zimmer facilities around the world and listing the number of critical, major and minor observations resulting from each audit, but without any description of the nature of those observations.[96] The Opinion accepted Plaintiffs' inference that this slide "informed [the Board] of the poor results of at least two – and potentially all three – of Zimmer's 2016 North Campus internal audits."[97] The Court of Chancery correctly determined, however, that the North Campus audit results were in line with "[t]he results of 11 other audits at Zimmer facilities."[98] Nothing "singled out" North Campus, and "[P]laintiffs acknowledge that the May 3, 2016 presentation was largely '[l]ike other presentations before it[.]'"[99] The Court of Chancery properly found that this slide did not provide "particularized allegations supporting a reasonable inference that the

[95] *See generally* Op.40-43, 45-46; *see also* Op.41-42 (referencing ¶159 reproducing slide from Complaint).
[96] Op.41-42.
[97] ¶159. The Court of Chancery accepted this inference. Op.41.
[98] ¶159; Op.42.
[99] Op.42 (quoting ¶158).

Board knew the results of the North Campus internal audits would spell…'disaster.'"[100]

Next, the Opinion explained why a slide from a presentation at the next Board meeting, on July 15, 2016, did not support a reasonable inference that the Board knew that "the severity and scope of Zimmer's manufacturing problems" "would escalate and cause Zimmer to suffer financial harm in the future."[101] This slide discussed more than a dozen facilities, and devoted only one line to North Campus.[102] Again, it did not single out North Campus, and Plaintiffs fail to explain why telling the Board that North Campus's remediation activities were scheduled to last until 2018 necessarily informed the Board that North Campus's compliance issues would cause Zimmer financial harm. Plaintiffs point to nothing in the May or July 2016 presentations that referred to the "*shutdown*" that they assert caused the ultimate injuries to Zimmer.[103]

The Court of Chancery also reviewed the information provided to the Board after the FDA's inspection began on September 12, 2016, finding that "no well-pleaded facts stat[e] that the Board was told a facility shut down or product ship hold

[100] Op.42.
[101] Op.42-43; ¶¶166, 167.
[102] ¶166; Op.42.
[103] ACOB.35.

had occurred or would occur," and noting that Plaintiffs had described a product ship hold as "a 'rare consequence of an FDA inspection.'"[104] Plaintiffs' Brief identified no reversible error in this determination.

The other Board presentations in the Complaint confirm that the information the Board received about North Campus did not differ from the usual course. At every Zimmer Board meeting, the presentations had reported about some facilities experiencing compliance issues and some facilities where the compliance issues had been remediated. Plaintiffs do not suggest that the past remediation efforts had ever resulted in a shutdown or affected Zimmer's growth rate. The Court of Chancery observed that the presentations to the Board on which Plaintiffs relied "provide no indication that the North Campus was a 'ticking time bomb,'" but rather told "a story of Zimmer's ongoing efforts to ferret out compliance issues and fix them."[105]

Accordingly, the Court of Chancery properly found that Plaintiffs failed to adequately plead scienter.

[104] Op.45-46 (citing ¶19).
[105] Op.36.

(2) Plaintiffs' Challenges To The Court Of Chancery's Scienter Analysis Lack Merit

(i) *Plaintiffs improperly inject materiality into the scienter analysis.*

Plaintiffs recognize the high scienter standard applicable to their disclosure claims, explaining that only "directors who ***knowingly*** issue false statements 'may be considered to be interested for purposes of demand.'"[106] But Plaintiffs try to ignore the scienter element entirely in suggesting all they must do to state a disclosure claim is "plead facts identifying material, reasonably available information that was omitted from the disclosure."[107] By citing the elements for pleading a disclosure claim when the alleged misstatement was made in connection with a request for stockholder action, Plaintiffs misapply Delaware law.[108] Plaintiffs' authority is further distinguishable because that authority tested the complaint under Rule 12(b)(6), not Rule 23.1.[109]

Plaintiffs compound their misapplication of Delaware law by arguing that the Court of Chancery erroneously grafted a requirement that the Demand Board

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[106] ACOB.29 (quoting *In re infoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 991 (Del. Ch. 2007)).
[107] ACOB.31 (citing *Oliver v. Bos. Univ.*, 2000 WL 1091480, at *8 (Del. Ch. July 18, 2000)).
[108] *Id*.
[109] *Oliver*, 2000 WL 1091480, at *1 (applying Rule 12(b)(6) standard).

know of "financial consequences" onto the "law on materiality."[110] Again, the issue as it relates to demand futility is whether *scienter* has been adequately alleged such that the directors could face a substantial likelihood of personal liability for a non-exculpated breach of fiduciary duty claim. Materiality is an entirely different element of a disclosure claim. But, however reframed on appeal, the theory of Plaintiffs' Complaint is that undisclosed regulatory compliance issues purportedly made it impossible for Zimmer to achieve its organic revenue growth rate.[111] Consequently, and consistent with Plaintiffs' theory as pled in their Complaint, the Court of Chancery examined the information provided to the Demand Board about the effect of the compliance violations on Zimmer's production capabilities and, ultimately, its financial results.

Plaintiffs' cases are, therefore, inapposite because they concern materiality, not the state of mind of the directors. Even if those cases were relevant, they merely confirm the unremarkable proposition that complaints must plead facts

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[110] ACOB.32-33.

[111] *E.g.,* ACOB.29 (arguing Director Defendants were informed of "systemic" compliance issues and "massive necessary remediation efforts" that "made it impossible for Zimmer to achieve the accelerated organic revenue growth it touted."), ¶266 (listing quality control and FDA compliance problems at Zimmer's facilities requiring remediation as "undisclosed facts [that] made it impossible for Zimmer to accelerate organic revenue growth and eventually led to...shipment delays of key products.").

showing how the allegedly undisclosed information rendered the challenged statements materially misleading. Each case Plaintiffs cite is factually distinct from this case because in each one, unlike here, the court found a connection between information allegedly given to the board and the purported falsity of the challenged statements.[112]

(ii) The Court of Chancery did not narrow Plaintiffs' theory of liability.

This Court should also reject Plaintiffs' contention that the Court of Chancery improperly "narrow[ed]…the scope of the case" to compliance issues at North Campus and their effect on Zimmer's performance.[113] According to Plaintiffs, their theory of liability all along has been that "in addition to the North Campus problems identified by the 2016 audits, there was an obligation to disclose

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[112] *Compare In re Fitbit, Inc. Stockholder Derivative Litigation*, 2018 WL 6587159 (Del. Ch. Dec. 14, 2018) (cited ACOB.33-34) (internal reports provided to board showed key product did not work while company's public statements touted it); *and InfoUSA*, 953 A.2d at 990 (cited ACOB.28) (report provided to board directly contradicted language in SEC filing); *and Silverberg ex rel. Dendreon Corp. v. Gold*, 2013 WL 6859282, at *11-15 (Del. Ch. Dec. 31, 2013) (cited ACOB.34) (before directors sold shares, board was given combination of non-public information that should have alerted directors that public statements were false); *with* Op.32 ("Despite having access to the relevant Board minutes and materials, however, the plaintiffs cannot link what the directors learned about continuing FDA compliance challenges with any materially misleading statements they were responsible for making.").

[113] ACOB.30-32.

that there was a state of systemic compliance failures across the Company's facilities requiring costly remediation."[114] This argument is flawed.

First, Plaintiffs are re-writing their Complaint on appeal. The Complaint clearly based the breach of fiduciary duty claim on "statements and omissions about the purported successful integration and the Company's growing organic growth rate,"[115] which allegedly depended on North Campus.[116] The alleged material non-public information possessed by the PE Funds related to the audits of North Campus,[117] including the assertion that "North Campus [was] a ticking time bomb of adverse regulatory problems."[118] The challenged statements were purportedly false because they concealed risks to Zimmer's business from the "possible product holds and manufacturing shutdown, and massive costs of necessary remedial measures,"[119] which occurred at North Campus. In terms of injury to the Company, the Complaint focused on the FDA's inspection of North

[114] ACOB.35; *see also* ACOB.33.
[115] ¶195 (cited Op.30 as support for "[t]he gist of the plaintiffs' disclosure argument").
[116] ¶¶12,13.
[117] ¶15.
[118] ¶270.
[119] ¶212.

Campus and its effect on the Company, including the product ship hold and the filing of the Securities Action.[120]

Even on appeal, Plaintiffs identify the injury to the Company as "FDA-mandated shipment delays which made it impossible for Zimmer to achieve the accelerated organic revenue growth it touted," which again, occurred at North Campus.[121] As the Court of Chancery properly found, "[t]he primary harms alleged in this case began with the September 12, 2016 FDA inspection of the North Campus, which resulted in negative observations, product ship holds, a Form 483, and preceded reduced revenue guidance and a decline in Zimmer's stock price."[122] Even Plaintiffs' Brief here begins by describing the "Nature of Proceedings" as involving claims about regulatory compliance at North Campus.[123] This Court should reject Plaintiffs' hindsight efforts to re-frame their Complaint.

Second, the Court of Chancery ***did*** address the information provided to Director Defendants about compliance issues relating to facilities other than North Campus, and concluded that it ***also*** failed to support Plaintiffs' effort to plead scienter.[124] The Court of Chancery correctly found that none of the regulatory

[120] ¶¶18-28.
[121] ACOB.29.
[122] Op.45
[123] ACOB.1-2.
[124] Op.34-40.

issues at other facilities made the temporary shutdown at North Campus "easily foreseeable," as Plaintiffs claimed.[125] Indeed, "[n]one of the references to 'systemic' issues or negative observations at other Zimmer facilities are alleged to be related to what eventually transpired at the North Campus."[126] Plaintiffs do not and cannot make any connection between the types of issues affecting other Zimmer facilities and the regulatory compliance issues at North Campus. Opting for quantity over quality, they simply use the word "systemic" throughout their Brief. But repetition is not a permissible substitute for particularized facts.

(iii) The Court of Chancery correctly rejected Plaintiffs' unreasonable inference that the Board was fully informed of the details of the North Campus audits.

Plaintiffs criticize the Opinion, contending that they are entitled to the inference that Director Defendants received copies of the audit reports.[127] The Court of Chancery noted that "there are no particularized facts pleaded in support" of this assertion.[128] Plaintiffs fail to identify any such particularized facts on appeal, arguing instead simply that they are entitled to the inference.[129] Plaintiffs' argument is not

[125] Op.33 (quoting ¶112); Op.35-36.
[126] Op.35.
[127] ACOB.35-36.
[128] Op.41.
[129] ACOB.35-36.

credible because the ipse dixit inference they seek is unreasonable. The Section 220 production included all Board materials from the time of the Merger through the end of 2016 related to quality systems and/or quality controls at the Company's manufacturing facilities. The audit reports ***were not*** in these materials, and Plaintiffs know it.[130] Plaintiffs' authorities, moreover, are inapposite: they merely cite Ct. Ch. Rule 9(b) and a case involving a fraud claim between a contractual buyer and seller which has no applicability here.[131] As *Zuckerberg* confirms, the evaluation of a claim under Rule 23.1 involves stringent standards and requires particularized facts supporting the inferences Plaintiffs seek.[132] The Court of Chancery correctly found that the Complaint here lacks such particularized facts.

(iv) Nothing in the Securities Action or the Barney Litigation undermines the Court of Chancery's opinion.

Plaintiffs draw heavily from the ruling on the motion to dismiss in the Securities Action to support their argument.[133] Plaintiffs' position is essentially that because the Court in *Shah* found scienter, the Court of Chancery should have too.

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[130] A64 (stating Plaintiffs reviewed and based Complaint on Section 220 production).
[131] ACOB.36 (citing *Prairie Cap. III, L.P. v. Double E Holding Corp.*, 132 A.3d 35, 62 (Del. Ch. 2015)).
[132] *Zuckerberg*, 2021 WL 4344361, at *7.
[133] ACOB.6, 21-23, 33 (citing *Shah*, 348 F. Supp. 3d at 826, 827, 839-42).

Not so. The only claims asserted against directors in the Securities Action that survived a motion to dismiss were claims under Section 11 of the Securities Act, which provides for strict liability when a registration statement contains a material misstatement or omission, and does not require proof of scienter.[134] Accordingly, the *Shah* decision did not make ***any*** findings whatsoever as to ***any*** Demand Board director's state of mind.

Moreover, it would be entirely inappropriate to superimpose the *Shah* scienter analysis on the Demand Board directors here. The *Shah* scienter analysis relates to the ***knowledge of management***, and it does not support an inference about what the Demand Board directors supposedly knew for several reasons. The *Shah* decision went through a "holistic analysis" of six points related to scienter. The audit reports were only one of those factors, and the *Shah* court never suggested the Board saw them. In fact, the *Shah* decision is clear that it was only "***ZBH and the ZBH Management*** [that] learned of massive problems at North Campus via its internal audit reports."[135] The Section 220 documents confirm that the Board did not see the

[134] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).
[135] *Shah*, 348 F. Supp. 3d at 842 (emphasis added); *id.* at 835, 846. As the Court of Chancery explained, language in the *Shah* ruling about a "time bomb" does not appear to apply to Director Defendants. Op.61 n.265. The same reasoning dooms Plaintiffs' reliance on language in *Shah* about the product hold allegedly being "inevitable." *Id.* at 840 (cited ACOB.22).

audit reports, and the single summary slide the Board did see was not enough to provide them actual knowledge of the audit report contents or that those contents rendered Zimmer's statements false.[136]

The remaining five factors were based on confidential witnesses and a former employee's allegations in an employment suit ("*Barney*"). Those allegations are not pled in this Complaint, and regardless, have nothing to do with the Board. Plaintiffs' Brief cites an email from *Barney* that they ***did not plead***, but asked the Chancery Court to judicially notice in their brief below.[137] But even if it were proper for Plaintiffs to amend their Complaint in such a manner (it is not), that email was not sent to the Board, says nothing about the Board, and otherwise sheds no light on what the Board knew.[138] Indeed, the scienter allegations in *Shah* and the allegations Plaintiffs draw from *Barney* were related to a coverup concerning oral statements made by certain members of Zimmer management on the October 31 earnings call. The Board is not alleged to have had any involvement in or responsibility for these statements.

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[136] *Supra* Facts §§C-D.
[137] ACOB.9-10.
[138] *Id.*

Accordingly, the Court of Chancery correctly found that *Shah's* scienter analysis did not apply to the Director Defendants.[139] The Court of Chancery further observed that, while *Fitbit* relied on the decision in a related federal securities action, it merely "reinforced the court's conclusion that knowledge had been sufficiently pleaded."[140] In other words, the federal decision was confirmatory to the *Fitbit* court; it did not provide the factual basis for the court's ruling.

Plaintiffs cannot rely upon the allegations and ruling in *Shah* (or *Barney* allegations) to compensate for their Complaint's deficiencies. Here, no facts are pled showing that the Board had actual knowledge of the severity of the issues at North Campus, that the Board knew when the FDA would inspect North Campus, that the problems were not being promptly remediated, or that Zimmer could not meet its growth targets while remediating North Campus.

(3) The Court of Chancery Correctly Found That Plaintiffs Failed To Plead Board-Level Involvement As To Many Of The Challenged Statements.

The Court of Chancery also properly concluded that Plaintiffs failed to plead demand futility for the independent reason that they did not plead Board-level

[139] Op.63.
[140] Op.63 (citing *Fitbit*, 2018 WL 6587159, at *16-17).

involvement in the challenged statements. This requirement is well-established and has been examined by numerous Court of Chancery rulings.[141]

Plaintiffs challenge a hodgepodge of statements, some made in SEC filings, some in press releases, and some made by individuals. To the extent Plaintiffs seek to hold the Director Defendants responsible for statements on the basis that they had some unspecified role in approving, consenting, causing, or allowing these statements, the Court of Chancery correctly found that these allegations fail to show sufficient Board involvement.[142] Plaintiffs' authorities do not refute this conclusion; they actually support it.[143]

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[141] *See, e.g.*, *Fisher*, 2021 WL 1197577, at *19 (complaint failed to allege directors played a role in making challenged statements); *Steinberg*, 2018 WL 2434558, at *10-11 (complaint lacked factual allegations reasonably suggesting sufficient board involvement in preparation of challenged statements); *Ellis ex rel. AbbVie, Inc. v. Gonzalez*, 2018 WL 3360816, at *7-10 (Del. Ch. July 10, 2018) (no allegations directors caused officer to make statements at investor conference; allegation that directors "reviewed and approved" misleading statements "is not particularized enough"), *aff'd*, 205 A.3d 821 (Del. 2019); *Citigroup*, 964 A.2d at 133-34 (no factual allegations showing board's involvement in challenged statements); *In re Dow Chem. Co. Deriv. Litig.*, 2010 WL 66769, at *10 (Del. Ch. Jan. 11, 2010) (plaintiffs lacked "specific facts 'that reasonably suggest sufficient board involvement in the preparation of the disclosures'"). The question of board involvement was not addressed in *Malone* because the complaint in that case was pled as a direct not derivative claim and was dismissed on that basis. *Malone v. Brincat*, 722 A.2d at 5, 14-15 (Del. 1998).

[142] Op.38-40.

[143] ACOB.36-38 citing cases: addressing director liability for documents they signed, not that they approved, assisted with, or reviewed (*Kandell ex rel. FXCM,*

The Court of Chancery criticized Plaintiffs for lacking any support for their contention that directors are liable for public filings incorporated by reference in registration statements they signed.[144] Plaintiffs ignore this criticism and fail either to address the argument or provide any authority supporting it on appeal. They also ignore the Court of Chancery's ruling that (at most) any claim based on the Audit Committee's alleged approval of the October 2016 earnings release would support an exculpated claim for breach of the duty of care.[145] The Court of Chancery should be affirmed on these points both because its analysis was well-reasoned and because any challenges to it were waived on appeal under S. Ct. R. 14(b)(vi)(A)(3).

Plaintiffs focus their attack on the analysis of Board-level involvement in the documents relating to the three Offerings, but this Court need not reach that issue given Plaintiffs' failure to plead particularized facts supporting an inference of

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Inc. v. Niv, 2017 WL 4334149, at *3, *17 (Del. Ch. Sept. 29, 2017) (referencing defendants who signed Form 10-Ks); *In re Hansen Med., Inc. S'holders Litig.*, 2018 WL 3025525, at *9-10 (Del. Ch. June 18, 2018) (analyzing liability for Proxy which would have been signed by director defendants)); supporting Defendants because directors found not liable for documents they did not sign (*Ellis*, 2018 WL 3360816; *Citigroup*, 964 A.2d 106); or that do not address this issue (*Salzberg v. Sciabacucchi*, 227 A.3d 102, 114 (Del. 2020) (ruling about federal forum provisions); *In re China Auto Sys. Inc. Deriv. Litig.*, 2013 WL 4672059 (Del. Ch. Aug. 30, 2013) (examining scienter)).

[144] Op.39 n.182.

[145] Op.48-51.

scienter based on information provided to the Demand Board at the time of those Offerings.

c. The Court of Chancery Correctly Found That Plaintiffs Failed To Plead That A Majority Of The Demand Board Faced A Substantial Likelihood Of Liability On Any Claim Relating To Insider Trading.

(1) Plaintiffs Do Not Identify Any Liability For Insider Trading That Could Affect A Majority Of The Demand Board.

The Court should affirm the Court of Chancery's dismissal of Plaintiffs' insider trading based claims[146] because Plaintiffs do not identify a substantial likelihood of liability for insider trading that could affect a majority of the Demand Board. On appeal, Plaintiffs emphasize the conduct of the PE Funds and their two Board representatives (Michelson from KKR and Rhodes from TPG),[147] but have no answer to the undisputed facts that:

- ***None*** of the Demand Board's directors sold stock in the Offerings;[148]
- Only ***one*** Demand Board director (Michelson) is alleged to have personally benefitted from the PE Funds' sales through his relationship with a PE Fund (Rhodes was not part of the Demand Board);[149] and

[146] *Brophy v. Cities Serv. Co.*, 70 A.2d 5 (Del. Ch. 1949).
[147] ACOB.41-44.
[148] Op.52.
[149] Op.52-53; ACOB.41-42.

- There are no allegations that the PE Funds controlled anyone else on the Demand Board.[150]

Claims affecting only ***one*** out of ***eleven*** directors are insufficient to plead demand futility.[151] Therefore, the Court of Chancery's conclusion that Plaintiffs failed to plead a substantial likelihood of liability for insider trading should be affirmed.

(2) The Court Of Chancery Appropriately Rejected Plaintiffs' "Knowing Facilitation" Theory.

Plaintiffs try to save their insider trading claims by arguing that a majority of the Demand Board faces a substantial likelihood of liability – not for insider trading itself – but because they approved the Offerings and thereby "knowingly facilitated" the PE Funds' alleged insider trading.[152] This argument lacks merit for several independently dispositive reasons.

(i) This "novel" theory merely repackages the failed disclosure claim.

As the Opinion correctly found, this "knowingly facilitated" theory "is simply another iteration of the plaintiffs' disclosure claim,"[153] and it should be likewise

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[150] Op.52; ACOB.41-44.
[151] *China Auto.*, 2013 WL 4672059, at *10 (plaintiffs' allegations did not implicate majority of board); *Harold Grill 2 IRA v. Chênevert*, 2013 WL 3014120, at *4 (Del. Ch. June 18, 2013) (plaintiff's allegations related to only one board member).
[152] Op.53; ACOB.44-47.
[153] Op.53.

rejected. Indeed, every case Plaintiffs' Brief cites in support of this theory involves a situation where investors were allegedly misled by public statements that were found to be made with scienter ***in addition to*** the directors' conduct in approving options or otherwise assisting an offering or insider trading.[154] Some of the cases also relied on the directors at issue receiving a personal benefit.[155] In other words, the claim in each of those cases was based on a combination of scienter ***plus*** the alleged act of facilitation or a personal benefit, not facilitation alone. As addressed above, Plaintiffs have not alleged a likelihood of liability for a disclosure claim due to the lack of scienter, nor even suggested the possibility of a personal benefit for ten of the eleven Demand Board directors. Plaintiffs offer no legal support for the proposition that directors who did not mislead investors and who received no personal benefit

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[154] ACOB.44-47 (citing *In re Emerging Commc'ns, Inc. S'holders Litig*., 2004 WL 1305745, at *31 (Del. Ch. May 3, 2004) (misleading proxy); *Ryan v. Gifford*, 918 A.2d 341, 355-56 (Del. Ch. 2007) (liability based on allegedly misleading investors about backdated options, not for simply approving the options); *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 590-91 (Del. Ch. 2007) (misleading investors about spring-loaded options); *Fitbit*, 2018 WL 6587159, at *12, *15-16 (directors supposedly knew company's key product did not work despite public statements about what devices could do); *In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at *40-41 (Del. Ch. Aug. 27, 2015) (misrepresentations drove down stock price).

[155] *Emerging Commc'ns*, 2004 WL 1305745, at *39-40 (directors received personal benefits from alleged misconduct of another); *cf. Dole Food*, 2015 WL 5052214, at *40-41 (discussing facts in *Emerging Communications* and finding director not liable for approving transaction because he did not receive personal benefit).

can nonetheless be liable for a breach of the duty of good faith for approving an offering.

(ii) Plaintiffs fail to plead facts supporting this theory.

Even if a claim of "knowing facilitation" for merely approving an offering were a valid legal basis to find a likelihood of liability for insider trading (it is not), Plaintiffs still failed to plead any facts showing the Board had the requisite knowledge to apply that legal theory here. As the Court of Chancery held, the relevant inquiry is not whether the Board knew about compliance issues before the Offerings, it is whether (1) a majority of "the Board knew that the PE Funds also had that material non-public information before selling their Zimmer shares in the Offerings," ***and*** (2) a majority of the Board knew "that [the PE Funds] sales were based on that information."[156] As the Court of Chancery correctly concluded, there are no facts alleged suggesting ***a majority of the Demand Board knew*** either: (1) what information was given to PE Funds, or (2) why the PE Funds sold when they did.[157] Specifically, despite Plaintiffs having the benefit of Section 220 documents, the Complaint contains no well-pled allegations:

- That the Director Defendants had knowledge of material non-public information concerning the North Campus compliance issues, as described *supra* (nor do Plaintiffs plead any material non-public

[156] Op.54.
[157] Op.56

information that Michelson and Rhodes possessed from their prior positions as Biomet directors);

- That Michelson or Rhodes shared that material non-public information with the PE Funds;[158]

- That a majority of the Demand Board knew about any such sharing;[159]

- That the PE Funds' trades were based on any such material non-public information;[160] and

- That a majority of the Demand Board knew that the PE Funds traded on any such basis.[161]

Any one of these deficiencies is fatal to Plaintiffs' "knowing facilitation" claim.

(iii) Plaintiffs' proposed inferences are unsupported and unreasonable, but even if accepted would not save Plaintiffs' claims.

Plaintiffs' only answer to their pleading deficiencies is that they are entitled to inferences in their favor.[162] But it is well-established that Rule 23.1 cannot be

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[158] Op.55-56.
[159] Op.56 & n.246 (noting that *Fitbit* did not need to address whether information was shared with outside entities or whether majority of demand board knew information was shared because claims in *Fitbit* involved trades by directors or funds they controlled, not trades by "outside entities that were connected to a single member of the demand board").
[160] Op.56.
[161] Op.56.
[162] ACOB.41, 43-44, 47.

satisfied by conclusory inferences; it requires particularized facts.[163] The inferences that Plaintiffs seek to draw here are neither supported by facts nor reasonable, and should be rejected. But even so, the requested inferences still fail to show the critical point Plaintiffs needed to make: knowledge by a majority of the Demand Board.

Plaintiffs ask this Court to infer, as they did below, that Michelson and Rhodes shared material non-public information with the PE Funds based not on any alleged facts, but solely on their positions as representatives of the PE Funds serving on a board, and the fact that the Stockholders Agreement permitted information sharing with the PE Funds.[164] The Court should reject this unsupported inference for the same reasons the Court of Chancery did: Plaintiffs' Complaint "discusses the *potential* for the PE Funds to access information based on the Stockholders Agreement. There are no particularized allegations that Michelson or Rhodes actually shared any information with the PE Funds."[165]

The exact same inference Plaintiffs seek here was also rejected by the federal court in the Securities Action, for the same reasons.[166] The *Shah* court dismissed insider trading claims against the PE Funds, finding that the plaintiffs there could not

[163] *Supra* Argument §A(3)(a).
[164] ACOB.41-43.
[165] Op.56.
[166] *Shah*, 348 F. Supp. 3d at 849.

plead possession of material inside information based on the "inference that the Private Equity Defendants (none of whom have been alleged to be involved in the management of ZBH) knew about the litany of problems at the North Campus by virtue of the presence of Rhodes and Michelson on ZBH's Board of Directors."[167] The plaintiffs there pled "nothing more than that the Private Equity Defendants had *potential* access to insider information. But '[a]ccess to information is not the same as actually possessing the specific information and knowing it[.]'"[168] The same is true here, and should likewise be rejected.

Plaintiffs cite an article co-written by Vice Chancellor Laster, but that article merely observes that Delaware law does not forbid information sharing and that representative directors often do share information with the entity they represent.[169] It says nothing about what transpired here – *i.e.*, whether and what information Michelson and Rhodes shared with the PE Funds (not to mention when). Unlike here, the case cited in the article describes in detail "reports made by VC-fund blockholder directors to their respective funds with regard to [the company's]

[167] *Id.*
[168] *Id.* (quoted Op.55).
[169] ACOB.43

performance."[170] That case sharply contrasts with this case where Plaintiffs allege nothing but speculation.

Plaintiffs also argue that the Court may infer, based on the nature, timing and size of the PE Funds' trades, that they traded on the basis of material non-public information.[171] That inference is unreasonable because the Stockholders Agreement – which was executed in 2014, years before the Offerings – both prohibits trades based on inside information, and suggests that well before any North Campus compliance issues arose, long-term Biomet investors had already formed a plan to exit their investment following the merger. Regardless, even accepting that unreasonable inference, it still offers no basis for the Court to then infer the critical point: that ***a majority of the Demand Board knew*** either that the PE Funds had material non-public information at all, or the basis for the PE Funds' trades.[172] Indeed, the Court of Chancery agreed that Plaintiffs' claim would still fail even accepting the inferences Plaintiffs seek, reasoning that "even if the court were to infer that Michelson and Rhodes shared material non-public information with the PE Funds, the Complaint lacks any basis to infer that the rest of the Board had

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[170] J. Travis Laster & John Mark Zeberkiewicz, *The Rights & Duties of Blockholder Directors*, 70 Bus. Law. 33, 55 n.112 (Winter 2014/2015) (citing *In re Trados Inc. S'holder Litig*., 73 A.3d 17, 23-24 (Del. Ch. 2013)).
[171] ACOB.44.
[172] ACOB.44.

knowledge regarding this alleged information sharing."[173] That is fatal to Plaintiffs' claim.

Any other grounds for the inference of "knowing facilitation" that Plaintiffs seek (such as the waiver of a lockup agreement or stock repurchase) have not been raised in Plaintiffs' Brief and are therefore waived under S. Ct. R. 14(b)(vi)(A)(3). But even if they were not, they would still fail for the reasons expressed by the Court of Chancery below.[174]

CONCLUSION

For the reasons set forth herein, the judgment below should be affirmed.

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[173] Op.56.
[174] Op.56-58.

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