EFiled: Jan 19 2022 02:20PM EST
Filing ID 67246102
Case Number 304,2021

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE ZIMMER BIOMET HOLDINGS, INC. DERIVATIVE LITIGATION	No. 304, 2021 Court Below: Court of Chancery of the State of Delaware, Consolidated C.A. No. 2019-0455-LWW

APPELLANTS' REPLY BRIEF

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Dated: January 11, 2022

Public Version Filed
January 19, 2022

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PRELIMINARY STATEMENT

Defendants-Appellees' ("Defendants") Answering Brief illustrates the errors made by the Court of Chancery ("Court") in dismissing the Complaint.[1] Defendants present multiple pages of self-serving interpretations of internal Board minutes designed to convey their own preferred version of events. These arguments offer factual conclusions not alleged in the Complaint and go well beyond the appropriate scope of what is permissible on a pleading motion. Instead of accepting Plaintiffs' factual allegations as true and drawing all reasonable inferences in favor of Plaintiffs, the Court weighed competing versions of the facts and erroneously resolved such disputes in Defendants' favor with respect to the meaning of key exhibits. Defendants' efforts at muddying the record with an alternative narrative is a transparent attempt to affirm the dismissal of the Complaint on demand futility grounds without discovery into disputed factual issues ever occurring. As explained in the Opening Brief, Plaintiffs' allegations suffice to state non-exculpated claims for breach of fiduciary duty against a Board majority, and demand is excused.

Defendants' arguments collapse under the weight of their own contradictions. Defendants admit they received detailed FDA compliance reports about Zimmer's

[1] Unless otherwise indicated, capitalized terms have the same meaning as set forth in the Opening Brief ("Op. Br.").

factory compliance violations at every Board meeting, but conveniently disavow that they knew anything about the abject condition of the Company's *most important facility*, the North Campus. Answering Brief ("Ans. Br.") at 5, 12-17. They acknowledge receiving certain information in May 2016 about the disastrous North Campus internal audits, but claim the violations they were advised of were not "substantive" and showed nothing out of the ordinary. *Id*. They disavow responsibility for repeatedly issuing misleading SEC filings despite the bedrock requirement that Delaware directors make complete and truthful disclosures under the federal securities laws. *Id.* at 21-22. And finally, they distance themselves from the massive, multi-billion dollar stock sales conducted by the PE Defendants conveniently timed to occur before the truth was revealed (*id.* at 10-12), even though such sales were made pursuant to the Stockholders Agreement which: (a) explicitly empowered certain directors to share inside information with the PE Defendants (¶¶85-86, 255-257[2]; A435-437) and (b) required the Board to personally assist in registering the PE Defendants' stock. (A452). The Court erred by improperly siding with Defendants on *all* of these points.

Under Delaware law, the Court cannot substitute competing inferences proffered by Defendants for those based on facts alleged in the Complaint. The

[2] ¶_ refers to the Verified Consolidated Stockholder Derivative Complaint (A62).

Court may not weigh whose proposed inferences are more reasonable, but rather, accepting Plaintiffs' particularized allegations as true and affording Plaintiffs the benefit of all reasonable inferences therefrom, the Court must assess whether Plaintiffs have stated a non-exculpated claim. The Court violated this basic principle. This is not a motion for summary judgment and Defendants' interpretations of the exhibits plainly raise disputed issues of fact not suitable for decision on a motion to dismiss. Furthermore, Defendants' unique "spin" on a few internal documents, obtained via Plaintiffs' investigation pursuant to 8 Del. Code § 220 ("Section 220 Documents"), and their efforts to impose their own competing interpretations as to dispositive facts, undermine Delaware precedent on the appropriate use of documents obtained in a books and records investigation.

The appropriate and reasonable inferences drawn from the Complaint demonstrate that Zimmer's Board knew of systemic violations of FDA regulations placing Zimmer on the precipice of a regulatory disaster, which predictably came to fruition, causing enormous losses in shareholder value and exposure to corporate liability. Although Defendants seek to minimize what the Board knew, given the scope of internally documented regulatory failures reflected in Board documents and FDA correspondence, and the hundreds of millions of dollars spent on unsuccessful remediation efforts, those facts, among others, support a reasonable inference that

the Board knew of both the regulatory violations and financial consequences of its continuing failure to correct systemic quality control issues.

Indeed, Defendants' largely ignore the detailed factual allegations and reasonable inferences cited at pages 10-18 of the Opening Brief – which present a cumulative picture of the Board's ever increasing knowledge of systemic problems across Zimmer's production facilities as time went on, including (but not limited to) critical and major violations uncovered at the North Campus. Rather, they attempt to re-write the Complaint by presenting their own preferred narrative of those same events relying on a disputed version of the facts. Defendants' claims that the Board was well-informed and regularly updated cannot be squared with their contention that they knew nothing about the scope of systemic manufacturing problems including the results of the audits or the significance of those findings.

Further, Plaintiffs' demand futility allegations are premised on several concepts supporting a finding of bad faith conduct by the directors. These allegations and the inferences must be viewed holistically in the aggregate. *Del. County Emples. Ret. Fud v. Sanchez*, 124 A.3d 1017, 1022 (Del. 2015). Specifically, facts regarding Defendants' disclosure violations, actual knowledge of a broad spectrum of undisclosed quality and compliance problems, concealment of this material non-public information from the offering documents and other filings, facilitation of

massive insider trading by the PE Defendants, and failure to ensure compliance with Zimmer's regulatory obligations as a highly regulated entity in conformance with their duty of loyalty, all support a finding of bad faith and demand futility.

As set forth in the Opening Brief and further addressed below, there is reason to doubt that a majority of the Board could disinterestedly respond to a demand based on their substantial likelihood of liability for breach of fiduciary duty, and demand is therefore excused.

ARGUMENT

A. A Majority of the Board Faces a Substantial Likelihood of Liability for Making False and Misleading Statements.

The parties agree that the operative inquiry under *United Food and Com. Workers Union and Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, et al.*, 262 A.3d 1034 (Del. 2021) is whether a majority of the Board "faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand." In the Opening Brief, Plaintiffs laid out the elements for stating a non-exculpated disclosure claim against the directors, referencing analogous cases in which similar claims were sustained for false and misleading SEC filings under Delaware law. Op. Br. at 24-39.

Defendants' argument that Plaintiffs "misapply" Delaware law by citing authority involving a request for board action is meritless. Ans. Br. at 32. Whether a disclosure claim is based on a request for shareholder action or not, the key principle remains the same: "Whenever directors communicate publicly or directly with shareholders about the corporation's affairs, with or without a request for shareholder action, directors have a fiduciary duty to shareholders to exercise due care, good faith and loyalty." *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998). As reflected by the cases cited in the Opening Brief (at pp. 28-29), the issue at the demand futility stage is whether Plaintiffs have alleged the required elements for a

disclosure claim with particularity so as to demonstrate a substantial likelihood of liability, as they have more than adequately done here.

Defendants' attacks on each of the key elements of Plaintiffs' disclosure claims only serve to highlight the flaws in the Court's reasoning.

1. Defendants Knew the Material Adverse Undisclosed Information.

Defendants' primary argument is that the Board knew nothing about how bad the Company's problems were, even though they concede (as they must) that the Board was regularly updated on FDA compliance issues and the regulatory status of Zimmer's medical device manufacturing facilities throughout 2015 and 2016. Ans. Br. at 27-31. This is confirmed by the Board record, as laid out in detail in the Complaint. *See* Op. Br. at 10-15 (detailing specific facts underlying Board knowledge of regulatory violations at key facilities as of the February 2016 offering and the 2015 Form 10-K, and mounting evidence of additional regulatory compliance violations at specific dates and Board meetings through the June and August 2016 offerings). Thus, the Board knew the seriousness of Zimmer's systemic quality control deficiencies from detailed presentations documenting FDA non-compliance and costly and unsuccessful prior remediation efforts. Op. Br. at 11-15. As the Defendants learned, those systemic FDA compliance problems, including those

at the North Campus, escalated in early- to mid-2016 with revelations of critical compliance failures documented in a series of internal audits and additional negative FDA findings. ¶¶122-125, 147n.15, 158-164; A658, A788-790. In short, these allegations support a reasonable inference of Board knowledge from at least February 2016 onward that Zimmer's widespread regulatory violations were a systemic problem at the North Campus and beyond. None of the challenged statements made in 2016 disclosed the severity of these issues. ¶¶259-266; A487-533, A879-1104.

Recognizing this problem, Defendants seize on the Court's analysis that the information presented to the Board was only general in nature. That is illustrated by the Court's discussion of the May 2016 Board report in particular, which shows that information was presented at a Board meeting concerning multiple audits, including the March, April, and June 2016 North Campus internal audits. Indeed, the Board was presented with a slide listing the disputed audits which, according to the chart, revealed a substantial number of "critical" and "major" violations at the North Campus – more than for any other facility listed. ¶159; A658. Nevertheless, the Court opined that the North Campus was not "singled out" in the May 2016 Board report and that other facilities were described with the "same level of detail." Opinion at 42.

This was plain error. Given the systemic violations and the severity of the North Campus problems confirmed *just months* later in connection with the FDA inspection and product hold, the only reasonable inference is that the Board was advised about the North Campus deficiencies at the May 3, 2016 Board meeting (¶¶158-164; A658, 660) and the subsequent July 15, 2016 meeting (¶¶165-171; A695). Systemic manufacturing violations were clearly on the Board's radar and would have been the whole point of the FDA compliance updates the Board received at each Board meeting. Although Defendants do not deny they were notified about systemic problems at Zimmer's facilities, they simply deny knowledge of the seriousness of the problems. These are quintessential disputed questions of fact the Court improperly resolved in Defendants' favor. Opinion at 41-44. Furthermore, the inference of Board knowledge is bolstered by the Company's admission to the FDA in December 2016 that: "After the merger was closed [in 2015], Zimmer Biomet Corporate directed corporate quality audits to be performed at the North Campus in the first half of 2016. *These audits self-identified major compliance-related issues in areas such as design controls, sterile packaging, complaint handling, nonconforming material, and [corrective and preventative actions ("CAPAs")].*" ¶122; A789; Op. Br. at 2, 12-13 (emphasis added).

Defendants spend significant effort disputing Plaintiffs' characterization of the May and July 2016 Board materials, arguing they do not specifically show the results of the North Campus audits. Ans. Br. at 12-17, 27-31. These are disputed factual issues concerning the meaning of multiple pages of documents and charts – that must be resolved in discovery. Defendants and the Court miss the larger, reasonable inference supported by these materials – that the Board reports reflects a bevy of compliance violations known to the Board at that time. Op. Br. at 10-15. The only reasonable inference is that an informed Board would be advised of the audit results, otherwise it would be falling short of its fiduciary obligations to oversee compliance in a mission critical area. Defendants' assertion that the facts show the Board was simply complying with its obligations to oversee FDA compliance matters (Ans. Br. at 31) is a factual dispute to be resolved following discovery.

Furthermore, Defendants rely on the Court's improper formulation of the allegations and claims pertinent to the scope and nature of Defendants' knowledge. As the Court conceded, Plaintiffs' disclosure claims were based on the theory that "Zimmer's officers and directors' knew *in 2015 and 2016* that Zimmer was facing serious regulatory compliance challenges" regarding its manufacturing processes but concealed them from investors. Opinion at 1 (emphasis added). However,

without basis or further explanation, the Court mistakenly narrowed the nature of Plaintiffs' claims to undisclosed problems that occurred *solely* at the North Campus. Opinion at 34.

Defendants now make the same mistake by framing Plaintiffs' disclosure claims as a "question [that] 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." Ans. Br. at 4, 34 (emphasis added). This is a fundamental mischaracterization of the wider allegations of systemic quality control issues at Zimmer's facilities. This attempt to re-write the narrative to fit the Court's incorrect holding that only facts surrounding the North Campus were relevant should be rejected. Plaintiffs' allegations of a broad array of systemic manufacturing compliance problems across Zimmer's facilities would inform the Board of the totality of circumstances related directly to the Defendants' knowledge of the underlying risks to the Company due to its deficient FDA compliance regime and potentially serious repercussions.

Such facts provide a basis for a reasonable inference of the Board's knowledge relevant to the claims and must be credited to Plaintiffs on a pleading motion. At the pleading stage, these facts and the reasonable inferences drawn from the Complaint easily suffice to allege contemporaneous Board knowledge of the adverse

information regarding serious compliance problems for purposes of stating a disclosure claim with particularity. Defendants will have the opportunity later in the case to present their version of events, after full merits discovery and under oath.

2. Defendants' Competing Interpretation of Certain Section 220 Documents Is Impermissible at the Pleading Stage.

The disputed factual issues supporting Defendants' narrative are premised on their interpretation of certain Section 220 Documents that are deemed incorporated into the Complaint. But "Section 220 documents, hand selected by the company, cannot be offered to rewrite an otherwise well-pled complaint." *In re Clovis Oncology, Inc. Derivative Litig*., C.A. No. 2017-0222-JRS, 2019 WL 4850188, at *14 n.216. (Del. Ch. Oct. 1, 2019). As the Court stated in *Amalgamated Bank v. Yahoo! Inc*., 132 A.3d 752, 798 (Del. Ch. 2016), abrogated on other grounds, 214 A.3d 933 (Del. 2019):

> If there are factual conflicts in the documents or the circumstances support competing interpretations, and if the plaintiff makes a well-pleaded factual allegation, then the allegation will be credited. The plaintiff also will be entitled to 'all reasonable inferences.' This means that if a document or the circumstances support more than one possible inference, and if the inference that the plaintiff seeks is reasonable, then the plaintiff receives the inference. (internal citations omitted)). *Yahoo!*, 132 A.3d at 798.

Defendants cannot "ask the Court in effect, to 'rewrite [Plaintiff's] well-pled complaint' in favor of their own version of events." *In re CBS Corp. S'holder Class Action & Derivative Litig*., C.A. No. 2020-0111-JRS, 2021 WL 268779, at *18 (Del.

Ch. Jan. 27, 2021), as corrected (Del. Ch. Feb. 4, 2021). Nor does the incorporation by reference doctrine enable the Court to weigh evidence on a motion to dismiss. *Id.* Instead, inspection documents only "test whether those inferences which are reasonable from the face of the Complaint are rendered unreasonable by reference to a document incorporated by reference." *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, C.A. No. 2019-0816-SG, 2020 Del. Ch. LEXIS 274, at *18, n.267 (Del. Ch. Aug. 24, 2020).

Plaintiffs did not misrepresent the Section 220 Documents, but instead, placed them in context to the serious and ongoing FDA regulatory and manufacturing problems Zimmer faced after merging with Legacy Biomet, and information provided to the Board beginning in 2015 and through 2016. Additionally, the Complaint references numerous other documents, not explained by Defendants within their hand-picked selection, that further support the allegations. For example, the May 2016 and July 2016 Board meeting materials show multiple Zimmer facilities with critical and major compliance problems, not just the North Campus. Other Board materials from December 2015 and February 2016 and correspondence submitted to the FDA reflect systemic problems back as far back as 2015. Op. Br. at 10-19 (seven critical and sixty two major quality system violations).

That Defendants simply present a different view of how a subset of documents might be interpreted does not justify accepting their inferences at the pleading stage, as they suggest. "Section 220 documents may or may not comprise the entirety of the evidence on a particular point. Until it is tested, the Defendants cannot ask the court to accept their Section 220 documents as definitive fact and thereby turning pleading stage inferences on their head. That is not and should not be, the state of our law." *Clovis Oncology,* 2019 WL 4850188, at *14 n.216. That approach, however, is exactly what the Defendants attempt here. As such, Defendants' effort to create their own counter-narrative and obtain inferences in their favor based on the Section 220 Documents fails.

3. The Undisclosed Adverse Information Was Material.

Defendants' brief concedes that materiality is an element of a disclosure claim, but is largely silent on the issue of materiality of the undisclosed information *here*. Materiality is ordinarily a fact-intensive inquiry not suitable for a decision on the pleadings. Op. Br. at 32. Likewise, Defendants fail to distinguish the reasoning of U.S. District Judge Philip Simon in *Shah v. Zimmer Biomet Holdings, Inc.*, 348 F. Supp. 3d 821 (N.D. Ind. Sept. 26, 2018), in which the district court held that allegations concerning undisclosed "quality systems issues" at the North Campus sufficed at the pleading stage to establish that the omitted information was material

(and therefore needed to be disclosed) for purposes of stating the factually related securities fraud claims. Nor do Defendants counter Plaintiffs' point that this precise reasoning extends to the particularized allegations about systemic compliance problems across *all* of Zimmer's facilities, as detailed throughout the Board record and in the Complaint, not just the North Campus. Op. Br. at 10-15.

In the Opening Brief, Plaintiffs also pointed out that the Court's formulation of materiality was incorrect in that it imposed a requirement that the insider know that the adverse information would "ripen into negative financial consequences." Op. Br. at 32-33; Opinion at 36. Plaintiffs cited numerous cases holding that the existence of undisclosed adverse inside information is enough at the pleading stage. Op. Br. at 32-36. There is no second part of this analysis requiring that Plaintiffs allege that the insider must anticipate precise effects once the undisclosed threat materializes. The inquiry focuses on whether the information would have significantly altered the "total mix of information" in the marketplace. *See Silverberg v. Gold*, C.A. No. 7646-VCP, 2013 WL 6859282, at *11 (Del. Ch. Dec. 31, 2013). Defendants cite no case adopting the Court's heightened materiality standard.

Indeed, the Court's analysis is another example of its failure to extend reasonable inferences to Plaintiffs. As of the July 2015 Board meeting, just shortly

after the Merger, the Board knew that the North Campus faced serious issues and had required substantial remediation efforts. ¶131; A553, A809-814. The North Campus in particular, which had a plethora of "critical" and "major" violations, was from a revenue standpoint the most important facility, and as Judge Simon held, there is a reasonable inference that a shutdown or other FDA sanction would occur. *Shah*, 348 F. Supp. 3d at 840 ("And given that the issues at the North Campus were alleged to be known and systemic in nature, it is not a stretch to think that absent full-remediation a product hold was inevitable."). For the directors to suggest (and the Court to accept) that they did not understand the likelihood of financial consequences for compliance problems defies common sense for these sophisticated, long-tenured directors.

4. Defendants Misapprehend and Misapply the District Court's Findings on the Section 11 Claims.

Defendants argue that the district court's decision in the federal securities class action sustaining Section 11 claims under 15 U.S.C. § 77k does not support a finding of scienter or bad faith against the Director Defendants in this case for breach of their fiduciary duty of disclosure under Delaware law. Defendants are wrong in conflating separate and distinct pleading standards in the federal case for Section 11 purposes with both the facts and pleading standards applicable in this case under Delaware law.

First, for the class action claims asserted against the directors based on liability under Section 11, the district court never made any finding, *one way or another*, whether the defendants' misconduct rose to a level of bad faith or knowing misconduct. The class plaintiffs were not required to and did not need to allege scienter in order to plead a claim under Section 11. The district court simply found those allegations satisfied the pleading elements for a Section 11 claim and reached no conclusions about whether Zimmer's directors acted with scienter or in bad faith. Because Delaware law under *Malone* separately imposes an obligation on officers and directors to act in good faith in disclosing all material information to stockholders, a different claim pled under federal law, with different elements, does not support a finding that the Defendants in this case did not act in bad faith.

Here the Court erred by making the same improper leap of logic as Defendants. Although director liability under the Securities Act may not require scienter as its minimum standard, it does not preclude misleading disclosures that are made knowingly and with intent, as the allegations in the Complaint here show. In short, bad faith actions by directors with respect to their duty of disclosure are not mutually exclusive to liability for Securities Act violations requiring a lesser standard of intent.

Second, the record before the district court for purposes of determining whether a Section 11 claim was pled was very different than the record here, which includes facts about Board meetings and directors' knowledge adduced from the Section 220 Documents – facts unavailable to the class plaintiffs and not part of the record in that case. The additional facts available in this case demonstrate the Board's knowing misconduct sufficient to support Plaintiffs' claims for bad faith breach of fiduciary duty. Accordingly, the absence of a finding of bad faith and knowing misconduct regarding the Section 11 claim is irrelevant to an assessment of knowing misconduct and bad faith alleged in the Complaint here.

5. The Board Was Responsible for the Disputed SEC Filings.

Contrary to Defendants' argument, Plaintiffs do not assert disclosure claims against the directors based on a "hodgepodge" of statements. Rather, Plaintiffs clearly described the false and misleading SEC filings for which Defendants were personally responsible as corporate directors. *See* Op. Br. at 18-19. In particular, Plaintiffs allege that the February, June, and August 2016 offering documents and the 2015 Form 10-K were false and misleading by omission. ¶¶33-42, 266. Notably, in *Shah*, Judge Simon sustained claims against the same directors based on allegations that the June and August 2016 offering documents were false and

misleading for omitting disclosure regarding the same regulatory problems at issue here. *Shah*, 348 F. Supp. 3d at 847.

Nevertheless, Defendants attempt to support the Court's flawed reasoning that the prospectuses were not personally signed by the directors, so they cannot be responsible for the contents. But as Plaintiffs explained, the prospectuses were issued pursuant to a shelf registration statement which the directors *did* sign, which is how the offering process works. *See* A1006, A1050, A1091 (the February, June, and August 2016 prospectuses were each a "part of" the underlying registration statement). The Court's reasoning immunizing the Director Defendants for disclosure violations in offering documents is directly contrary to the "historic," "compatible," and "complimentary" overlap of state and federal disclosure law this Court identified in *Salzberg v. Sciabacucchi*, 227 A.3d 102, 114 (Del. 2020), a directive the Court did not follow and that Defendants conspicuously fail to address.

It is precisely because directors "play a direct role in a registered offering," *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381–82 (1983), that directors are among the "limited and enumerated categories of defendants" subject to "near strict liability for untruths and omissions made in a registration statement." *Obasi Inv. LTD v. Tibet Pharm, Inc.,* 931 F.3d 179, 182 (3d Cir. 2019). By signing the registration statement, the directors "explicitly adopted them as their

own statements." *Zazzali v. Alexander Partners, LLC*, No. 12-CV-828-GMS, 2013 WL 5416871, at *7 (D. Del. Sept. 25, 2013) (citing *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142–43 (2011)). And with respect to the disputed Form 10-K, the directors signed it, which Defendants do not dispute. That is sufficient for disclosure liability. *In re InfoUSA, Inc., S'holders Litig.*, 953 A.2d 963, 991 (Del. Ch. Aug. 20, 2007) ("The Court may reasonably infer, based upon these allegations, that the directors who signed the 2004 and 2005 10-Ks did so knowing that the information contained therein fell far below the standards of candor expected from them.")

B. A Majority of the Board Faces a Substantial Likelihood of Liability for Knowingly Facilitating Unlawful Insider Trading.

As another basis for demand futility, Plaintiffs allege that a majority of the directors face a substantial likelihood of liability for knowingly facilitating the massive insider stock sales made by the PE Defendants affiliated with two directors before the adverse information was disclosed and Zimmer's stock price sank. ¶¶313-320. These stock sales, effectuated pursuant to registered offerings made by Zimmer pursuant to the demands of the PE Defendants themselves, required the full Board's participation and approval. Op. Br. at 40-47. The Court erred by failing to extend reasonable inferences to Plaintiffs regarding the incriminating nature of these stock sales due to their highly suspicious timing and size, and the Board's approval thereof, and disregarding analogous precedent sustaining this precise basis for director liability.

1. Michelson and Rhodes Engaged in Unlawful Insider Trading Through Their Respective PE Funds.

As explained in the Opening Brief, the Court failed to extend the reasonable inference to Plaintiffs that directors Michelson and Rhodes engaged in improper insider trading through the PE Defendants they represented. In *In re Fitbit, Inc. Stockholder Derivative Litig.*, C.A. No. 2017-0402-JRS, 2018 Del. Ch. LEXIS 571 (Del. Ch. Dec. 14, 2018), the Court sustained insider trading claims under *Brophy v.*

Cities Serv. Co., 70 A.2d 5 (Del. Ch. Dec. 14, 1949) against certain directors based on stock sales made by their affiliated investment funds. In doing so, the Court correctly recognized that any other ruling would undermine Delaware law and policy by allowing fiduciaries to hide from liability behind the trades of third party private investment firms to which they passed inside information. The Court stated unambiguously: "[t]hat is not and cannot be our law." *Fitbit*, 2018 Del. Ch. LEXIS 571 at *32.

Notably, in *Fitbit*, and contrary to the Court's reasoning below, there was no requirement imposed at the pleading stage that the shareholder plaintiffs allege the precise details of how and when the fiduciary shared adverse inside information with the affiliated fund. That is unsurprising, because such a requirement would frustrate the remedial purposes of the claim. As the Court in *Fitbit* reiterated in a decision refusing certification for an interlocutory appeal: "[I] am satisfied that it is not particularly novel or controversial as a matter of Delaware law to declare that a fiduciary may not share inside information with a fund he controls so that the fund, in turn, can trade on that inside information as a means to avoid *Brophy* liability." *In re Fitbit, Inc. Stockholder Derivative Litig.*, C.A. No. 2017-0402-JRS, 2019 Del. Ch. LEXIS 14, at *10 (Del. Ch. Jan. 14, 2019).

The reasonable inference of the sharing of inside information is far more compelling here than it was in *Fitbit*, because here it was formalized by contract. Indeed, the Stockholders Agreement provided the PE Defendants – through Michelson and Rhodes – with broad access to all materials provided to the Board, including all materials provided to each committee, as well as the right to attend all committee meetings, including those on which Michelson and Rhodes had no formal role. Section 1.6 of the Stockholders Agreement provided "Information Rights" granting the PE Defendants, including the ones represented by Michelson and Rhodes, access to non-public information related to the management, operations, and finances of Zimmer and its subsidiaries. ¶¶85-86, 255-257; A435-437.

Defendants ignore the logic and policy of *Fitbit* and, like the Court below, mistakenly rely primarily on Judge Simon's reasoning in *Shah*, in which the Court dismissed a claim for contemporaneous trading brought against the PE Defendants under Section 20A of the Securities Exchange Act of 1934. But in reaching that conclusion, Judge Simon was applying federal securities law to a direct claim brought by investors. In this derivative action, however, the Court was required to apply Delaware law under *Brophy* which provides for the equitable remedy of disgorgement to the corporation from disloyal fiduciaries. The Court should have applied Delaware law and recognized *Brophy* claims against Michelson and Rhodes

for trading on the Company's material non-public information, while taking into account the remedial purposes of holding fiduciaries to account, as the Court did in the *Fitbit* case. In addition, unlike in *Shah*, Plaintiffs here alleged detailed information that Michelson and Rhodes received at Board meetings, which was not part of the record before the district court.

Defendants likewise have no answer for Plaintiffs' allegations that the insider trades attributable to Michelson and Rhodes were suspicious in timing and amount, a key argument rooted in Delaware law raising a strong inference of insider trading that the Court failed to credit. Op. Br. at 44. Their only response is to assert that the sales by the PE Defendants were contemplated in advance by the terms of the Stockholders Agreement as part of a plan to liquidate their holdings after the Merger, but this is simply Defendants creating a factual dispute on the timing and motivation for the sales to support their version of events. As previously discussed herein, that is not proper at the pleading stage.

2. A Board Majority Faces a Substantial Likelihood of Liability for Facilitating Insider Sales Attributable to Michelson and Rhodes.

In the Opening Brief, Plaintiffs cited several cases in which claims against directors were sustained at the pleading stage for facilitating self-dealing by other fiduciaries, such as through insider trading or the receipt of backdated options. *See*

Ryan v. Gifford, 918 A.2d 341, 356 (Del. Ch. Feb. 6, 2007) (allegations that some directors "approved" improper option grants while others "accepted" them "are sufficient . . . to raise a reason to doubt the disinterestedness of the current board").

Defendants do not dispute that such claims can provide a basis for director liability and demand futility, but attempt to distinguish the cited cases because they supposedly involved situations 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." Ans. Br. at 46. Defendants point to no such requirement for such a non-exculpated breach of fiduciary duty claim to be stated. In any event, the distinction makes no difference, as that is precisely what Plaintiffs here allege.

Defendants seek to bolster the Court's reasoning that there are no allegations that the Board knew whether Michelson and Rhodes shared the alleged inside information with their respective investment funds, or what motivated the sales. Opinion at 54, 56. This argument is refuted by the nature of the disputed trades. As alleged in the Complaint, these were not ordinary private stock sales. They required the personal participation of all directors in effectuating registered offerings, pursuant to a Stockholders Agreement that had as one of its essential features the sharing of inside information with the PE Defendants. ¶¶85-86, 255-257; A435-437.

Of course, as the Section 220 Documents demonstrate, the same directors who conducted the offerings knew the same undisclosed information that Michelson and Rhodes did. ¶¶126-171; A534-713. Under these unique circumstances, the Board's knowledge of the allegedly improper insider trading is sufficiently alleged.

Indeed, that is also the logical result the Court reached in *Fitbit* to avoid creating untenable gaps in the law proscribing disloyal conduct by fiduciaries. In that case, the Court sustained demand futility allegations against a non-trading director (Paisley) for facilitating the registered offering of stock to be sold by funds controlled by his fellow directors, citing *In re Emerging Commc'ns Inc. Shareholders Litig.*, C.A. No. 16415, 2004 Del. Ch. LEXIS 70, at *146 (Del. Ch. May 3, 2004) (sustaining breach of fiduciary duty claims against a director with "unique knowledge" of unfair conduct by another director). The Court in *Fitbit* did not impose a separate inquiry at the pleading stage into Paisley's knowledge about how or when the directors shared information with their funds.

CONCLUSION

For the reasons set forth in the Opening Brief and herein, the Opinion dismissing the Complaint on demand futility grounds should be reversed.

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Public Version Filed
January 19, 2022

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