EFiled: Oct 23 2024 01:11PM EDT
Filing ID 74847023
Case Number 347,2024

IN THE SUPREME COURT OF THE STATE OF DELAWARE

VLADIMIR GUSINSKY REVOCABLE TRUST, Derivatively on Behalf of Nominal Defendant RTX CORPORATION,

Plaintiff below,
Appellant,

v.

GREGORY J. HAYES, TRACY A. ATKINSON, LLOYD J. AUSTIN III, MARSHALL O. LARSEN, THOMAS A. KENNEDY, GEORGE R. OLIVER, ROBERT (KELLY) ORTBERG, MARGARET L. O'SULLIVAN, DINESH C. PALIWAL, ELLEN M. PAWLIKOWSKI, DENISE L. RAMOS, FREDERIC G. REYNOLDS, BRIAN C. ROGERS, JAMES A. WINNEFELD, JR., and ROBERT O. WORK,

Defendants Below,
Appellees,

and

RTX CORPORATION,

Nominal Defendant Below,
Appellee.

No. 347, 2024

Court Below: Court of Chancery of the State of Delaware, C.A. No. 2022-1124-MTZ

PUBLIC VERSION

APPELLANT'S OPENING BRIEF

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NATURE OF PROCEEDINGS

This appeal calls on the Court to clarify an important fiduciary issue: whether, as a matter of pleading, a board of directors can avoid liability for failing to seek stockholder approval under an investor approved compensation plan by failing to expressly consider whether the plan required stockholder approval. Plaintiff alleges, derivatively on behalf of Raytheon Technologies Corporation n/k/a RTX Corporation ("RTX" or the "Company"), that RTX's Board of Directors ("Board") violated a plain and unambiguous provision of the Company's stockholder approved compensation plans by repricing equity awards without first obtaining stockholder approval. The Chancery Court took as true Plaintiff's allegations that the plans required stockholder approval but dismissed under Rule 23.1, holding that: (i) the Board's delegation of responsibility to "provide final approval" for the repricings to a Special Committee was not reasonably interpreted as giving the Special Committee power to finally approve them, regardless of the stockholder approval requirements of the plans; and (ii) because the Board minutes do not reflect any consideration of the requirements of the plans, knowledge of the violation of the plans sufficient to excuse demand could not be inferred. The Chancery Court's July 23, 2024 Letter Opinion ("Letter Opinion"), at 19-20.[1] The Chancery Court erred on both points.

[1] The Letter Opinion is attached hereto as Exhibit A.

This case arises from two modifications to equity awards owned by current and former employees of in April 2020 and May 2020. On April 2, 2020, United Technologies Corporation ("UTC") spun off two subsidiaries, Otis Worldwide Corporation ("Otis") and Carrier Global Corporation ("Carrier"), and then immediately merged with Raytheon Company ("Raytheon"). The new Raytheon/UTC entity became RTX.

Prior to the spinoff, in 2019, UTC's Compensation Committee approved formulas for the conversion of UTC equity awards in the spinoff. The formulas were memorialized in an Employee Matters Agreement ("EMA"). For unvested awards, the conversion formulas employed a ratio, the denominator for which was the volume weighted average price ("VWAP") of RTX, Otis, or Carrier stock, respectively, during the fourth and fifth trading days following the spinoff, April 8 and April 9, 2020. The formulas worked as intended and the value of the awards at market close on April 9, 2020 was effectively the same as at close on April 1, 2020, the last trading day before the spinoff.

[redacted] With the benefit of hindsight, the proposed EMA Amendment selected the lowest possible denominator

for the conversion ratio. [redacted], the Board unanimously resolved to delegate responsibility to "provide final approval" for the EMA Amendment to a Special Committee, and granted the Special Committee itself power to approve the EMA Amendment. The meeting materials reflect no consideration by the Board of the stockholder approval requirements in the relevant equity plans.

[redacted], the Special Committee approved the EMA Amendment, making the new denominator the price of RTX stock at open on the first day following the spin. The EMA Amendment was a [redacted] to RTX executives. For several reasons alleged in detail in the Complaint and summarized herein, the EMA Amendment was a separate modification to equity awards from the conversion in the spinoff and required stockholder approval. The Board never sought stockholder approval for the repricing in violation of the plans.

Plaintiff alleges that demand is excused because a majority of RTX's thirteen-member Board either received awards issued in violation of the compensation plans or violated the plans by failing to seek stockholder approval and instead giving the Special Committee power to finally approve the EMA Amendment, a power the Board lacked. Two directors received millions of dollars in benefit from the EMA

Amendment. Ten other directors unanimously decided to delegate final approval power to the Special Committee, unqualified by the stockholder approval requirement in the plans. The Company's governance documents and proxy statements tell stockholders that the full Board is responsible for seeking stockholder approval when necessary under the plans.

The Chancery Court's dismissal was in error for two primary reasons.

First, although the Special Committee Resolutions specifically give the Committee itself power to approve the EMA Amendment, the Chancery Court erroneously concluded that that the Resolutions "did not identify the Special Committee as the source of approval," and so the Committee's responsibility for "providing final approval" could include "procuring" stockholder approval. Letter Opinion, at 18-19. This is incorrect. The Resolutions *do* identify the Special Committee as the source of approval, and by the Resolutions' plain language the approval power is not subject to the requirements of the plans. The Chancery Court erred by failing to credit Plaintiff's reasonable interpretation of the Special Committee delegation at the motion to dismiss stage.

Second, the Chancery Court declined to draw an inference of Board knowledge of violation of the plans because, as alleged in the Complaint, Board minutes do not reflect consideration of the terms of the compensation plans. Letter

Opinion, at 20. But the Chancery Court erroneously declined to infer knowledge that the Board knew it was violating the plans, rather than knowledge of the existence of the stockholder approval requirement. The Board was responsible for administration of the plans and for seeking stockholder approval when necessary. Board knowledge of the stockholder approval requirements must be inferred at the motion to dismiss stage. Under the Chancery Court's reasoning, the Board can blamelessly remain ignorant of the terms of the plans that it is responsible for administering. This approach would give Boards an incentive not to consider the requirements of a stockholder approved plan to avoid potential liability for its violation. At most, courts require Board knowledge of the existence of the relevant provision if the allegations, taken as true, sufficiently allege that the Board violated a plain and unambiguous restriction in a stockholder approved compensation plan. *Garfield v. Allen*, 277 A.3d 296, 322 (Del. Ch. 2022). In other words, the question is not whether allegations of knowledge are sufficient; it is whether the allegations show that a plain and unambiguous provision of the plan was violated. *Pfeiffer v. Leedle*, 2013 WL 5988416, at *6 (Del. Ch. Nov. 8, 2013) Board knowledge of the provision should have been inferred and demand should be excused.

For these reasons and those that follow, Plaintiff respectfully submits that the Letter Opinion should be reversed.

SUMMARY OF ARGUMENT

1. The Chancery Court incorrectly determined that demand was not futile by failing to draw the inference that the Board's grant of authority to the Special Committee exceeded the Board's authority. The Chancery Court erred by disregarding Plaintiff's reasonable interpretation of the Special Committee Resolutions in favor of a less reasonable interpretation ignoring the express grant of approval power to the Special Committee. The reasonable interpretation of the Resolutions, based on the particularized facts of the Complaint is that Board granted final approval authority for the EMA Amendment to the Special Committee.

2. The Chancery Court failed to infer knowledge to the Board of the requirement for stockholder approval in the LTIPs. The Chancery Court erred by holding that bad faith could not be inferred from the Board's delegation of final approval power to the Special Committee because there was no record of the Board considering whether the LTIPs required stockholder approval. Authority addressing alleged Board violations of stockholder approved compensation plans infers knowledge from the violation of a plain and unambiguous provision of a plan itself. When courts evaluate whether facts support an inference of knowledge, they look for facts supporting an inference of knowledge of the violated plan provision, not evidence that the board knew it was violating the plan. The Complaint alleges that

a majority of the Board knew of the stockholder approval requirement and the facts taken as true establish a plain and unambiguous violation of that provision.

STATEMENT OF FACTS

In April 2020, UTC spun off Otis and Carrier. A052-53, ¶¶73-74.[2] UTC then immediately merged with Raytheon to create RTX. A066, ¶92. To effect the spinoff, the UTC Board approved a pro rata dividend whereby each UTC stockholder received one share of Carrier common stock and one-half share of Otis common stock for every share of UTC common stock. A055, ¶78. Previously issued UTC equity awards were adjusted to awards for post-spin entities.

A. The Equity Awards Were Issued Pursuant To Incentive Plans That Require Stockholder Approval For Repricing That Does Not Address The Impact Of Spinoffs

The equity awards at issue are governed by two UTC long term incentive plans, the UTC 2018 Long-Term Incentive Plan (the "UTC 2018 LTIP") and the UTC Long-Term Incentive Plan (the "UTC LTIP," and together, the "LTIPs"). A044, ¶54. They govern awards of stock options, performance-based stock units ("PSUs"), restricted stock units ("RSUs"), and stock appreciation rights ("SARs"). A045, ¶55. The LTIPs must be administered by the Compensation Committee, or other committee that may be designated by the Board "from time to time." A045, ¶¶56-57. The UTC 2018 LTIP requires, and the UTC LTIP permits, the Board to

[2] Citations to "¶_," refer to Plaintiff's Verified Amended Stockholder Derivative Complaint, filed May 18, 2023. *See* Appendix, at A026-109. Citations to "A__" refer to the appendix.

modify equity awards in the event of a spinoff. A045, ¶58, A047, ¶60. However, under the LTIPs, the exercise price of a SAR or stock option cannot be modified without stockholder approval, except in the case of a spinoff. A046, ¶59, A047-48, ¶61. Specifically, the LTIPs provide:

> In no event may any Stock Appreciation Right or Stock Option granted under this Plan be amended, other than [in connection with a spinoff or other corporate transaction], to decrease the exercise price thereof, be cancelled in exchange for cash or other Awards or in conjunction with the grant of any new Stock Appreciation Right or Stock Option with a lower exercise price, or otherwise be subject to any action that would be treated, under the Applicable Exchange listing standards *or for accounting purposes, as a "repricing" of such Stock Appreciation Right or Stock Option, unless such amendment, cancellation or action is approved by the Corporation's shareholders*.

A042, ¶50 (Section 5(c) of UTC 2018 LTIP); *see also* A047-48, ¶61 (Section of 5(c) of UTC LTIP, substantively identical to Section 5(c) of UTC 2018 LTIP).

When the Board solicited approval of the UTC 2018 LTIP in UTC's 2018 Proxy Statement, it asked stockholders to approve the plan because, among other things, certain "features have been incorporated into the Plan to protect shareowners' interest and mitigate potential risk," specifically including: "[n]o stock appreciation right or stock option repricing without shareowner approval." A048, ¶64. Defendants Marshall O. Larsen ("Larsen"), Margaret L. O'Sullivan ("O'Sullivan"), Frederic G. Reynolds ("Reynolds"), and Brian C. Rogers ("Rogers") were on the Board when it issued the 2018 Proxy Statement. A037-38, ¶¶22, 26, 30, 31.

At all relevant times, the Compensation Committee administered the LTIPs with oversight from the full Board. A044, ¶52. The Compensation Committee charter provides that the responsibilities of the Committee include making "recommendations to the Board [as to actions under the LTIPs] that require Board or shareowner approval" and "oversee[ing] the administration of the [LTIPs]." *Id*. Defendants Denise L. Ramos ("Ramos") and Rogers were members of the Compensation Committee between approximately December 2018 and the spinoff. A038, ¶¶29, 31, A059-60, ¶82.

B. The UTC Compensation Committee Approved An Equity Treatment That Aimed To Reflect The "True Value" Of The Post-Spin Companies

In 2019, the UTC Compensation Committee, comprised of Defendants Ramos and Rogers and non-parties John V. Faraci, Jean-Pierre Garnier, Ellen J. Kullman, and Harold W. McGraw III, approved the modification of equity awards in connection with the spinoff. A059-60, ¶82. Vested awards would be distributed using the basket method and converted into corresponding equity in each of the three post-spinoff companies. *Id.* Unvested awards would be distributed using the concentrated method would be converted to 100% post-spinoff employer awards. *Id.* The quantity and exercise price of the post-spinoff awards was governed by the ratio used to convert UTC equity into post-spinoff equity. A061, ¶84.

[redacted]

[redacted]

C. The Spinoff And Merger Closed

The spinoff and merger with Raytheon were completed on April 3, 2020, before the market opened. A066, ¶92. UTC stock closed at $50.73 on April 2, 2020. *Id.* After the merger, the price of RTX rose from $51.00 at open on April 3, 2020 to $64.71 per share on April 9, 2020. *Id.* The VWAP for RTX stock over the 4th and 5th trading days following the spin, April 8 and April 9, was $63.90. *Id.* Using the

April 8 and 9 VWAP in the conversion ratio yielded awards that had almost exactly the same value as at market close the day before the spin, April 2. *See* A090-91, ¶¶132-34.

D. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

E. The Board Delegates Final Approval Of The Modification To A Special Committee

[redacted] the Board approved the creation of a special committee comprised of Atkinson, Paliwal, and

Winnefeld (the "Special Committee"). A079, ¶113. [redacted]

[redacted] Given that the LTIPs require stockholder approval of modifications, the Board lacked authority to finally approve the Potential Amendment. The Board cannot delegate to the Special Committee a greater power than the full Board has.

[redacted]

[3] [redacted]

[redacted]

[redacted]

[redacted]

The Form 8-K filed on May 29, 2020 disclosing the EMA Amendment concealed the nature of the Board's action and misrepresented the effect of the amendment. A089-90, ¶131. It claimed that the EMA Amendment "treated employees and retirees fairly in the conversion process" following a "material discontinuity between the pre-Separation UTC stock price and the post-Separation Company stock price originally chosen in the [EMA]." A089, ¶130. In reality, the EMA Amendment conferred a several hundred-million-dollar windfall on the Company's insiders by repricing their equity awards with the benefit of hindsight. A089-90, ¶131. For example, 5,000 RSUs valued at $430,050 pre-spin were converted under the EMA to 6,730 RSUs worth $435,498.30 post-spin, but under the amended EMA to 8,432 RSUs worth $545,634.72 post-spin (a 25% increase). A090, ¶¶132-33.

The Conversion was designed to protect employees from volatility and express the true value of the post-spin entities, but when the Company's stock price unexpectedly increased in the days following the spinoff, RTX's executives realized that the formula prevented them from realizing the benefit of the unanticipated stock appreciation during the first week post-spin. A091-92, ¶135. Accordingly, they hatched a plan to change the Conversion by changing the measurement date to capture the unanticipated stock increase, providing themselves with an unearned

windfall. A092, ¶136. The Company neither sought stockholder approval for the repricing of the equity grants nor took any charge associated with the additional equity compensation. A092, ¶137.

F. Demand Is Excused To A Majority Of The Board

When this action was filed, RTX's Board consisted of thirteen directors, defendants Hayes, Atkinson, Oliver, Ortberg, O'Sullivan, Paliwal, Pawlikowski, Ramos, Reynolds, Rogers, Winnefeld, and Work, and non-party Harris. A094, ¶144. The entire Board unanimously delegated the power to finally approve the EMA amendment to the Special Committee. In their motion to dismiss briefing, Defendants conceded demand is excused as to Ortberg and Hayes. Letter Opinion, at 15 n.68 ("Defendants concede demand is excused as to directors Hayes and Ortberg, who owned significant unvested equity that were affected by the EMA Amendment and are thus not disinterested."). Additionally, Larsen, O'Sullivan, Reynolds, and Rogers were on the Board when it issued the 2018 Proxy Statement, specifically highlighting the stockholder approval requirement under the 2018 LTIP. A037-38, ¶¶22, 26, 30, 31. Ramos and Rogers were on the Compensation Committee, charged with administering the LTIPs, between December 2018 and the spinoff. As a result, demand is excused because whether knowledge of the stockholder approval requirement is inferred as to the full Board or only the directors

who administered the LTIPs and solicited stockholder approval for them, a majority of the Board could not disinterestedly consider a demand.

ARGUMENT

I. THE CHANCERY COURT ERRED BY FAILING TO DRAW THE REASONABLE INFERENCE THAT THE GRANT OF APPROVAL POWER TO THE SPECIAL COMMITTEE EXCEEDED THE BOARD'S AUTHORITY UNDER THE TERMS OF THE EQUITY PLANS

A. Question Presented

Whether pre-suit demand is excused because the Board exceeded its authority when it granted to the Special Committee power to finally approve the EMA Amendment in violation of the stockholder approval requirement of the LTIPs or otherwise acted in bad faith. *See* A197-202.

B. Scope of Review

The Court's review of decisions under Rule 23.1 is *de novo*. *Brehm v. Eisner*, 746 A.2d 244, 253-54 (Del. 2000).

C. Merits of Argument

1. The Chancery Court Erroneously Interpreted The Special Committee Delegation As Not Granting Final Approval Power

A reasonable interpretation of the Special Committee Resolutions is that the Board gave the Special Committee power to finally approve the proposed amendment, without regarding to seeking stockholder approval. The Chancery Court's holding to the contrary at the pleading stage was error and inconsistent with

principles of contract interpretation under Delaware law. "Delaware adheres to the 'objective' theory of contracts, *i.e*. a contract's construction should be that which would be understood by an objective, reasonable third party… [t]he true test is not what the parties to the contract intended it to mean, but what a reasonable person in the position of the parties would have thought it meant." *Sunline Com. Carriers, Inc. v. CITGO Petroleum Corp.*, 206 A.3d 836, 846-47 (Del. 2019) (quoting *Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1159–60 (Del. 2010)).

The LTIPs specifically require stockholder approval. [redacted] If, as the Chancery Court held, the Committee's

responsibility was to "procure" final approval from some other source, the grant to the Special Committee of power to approve would be meaningless. The reasonable reading of the Special Committee Resolutions, considering the approval power, is that the Board intended the Special Committee itself to finally approve the proposed amendment and gave it the power to do so.[4] Stockholder approval was not sought.

The Chancery Court erred by failing to credit Plaintiff's reasonable interpretation of the Special Committee delegation at the motion to dismiss stage. The Chancery Court should have "decline[d] to rule on construction… at the motion to dismiss" and instead denied the motion to dismiss where "one plausible" interpretation rendered demand excused. *California Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *11 (Del. Ch. Dec. 18, 2002). Although Plaintiff's interpretation of the Special Committee delegation was reasonable, the Chancery Court accepted Defendants' interpretation based on a secondary definition of the term "provide" as meaning "to procure or supply." Letter Opinion, at 19 ("Thus, the Resolutions tasked the Special Committee with 'procuring' final approval and gave it flexibility 'to undertake all actions that, in the determination of the

[4] [redacted]

[c]ommittee, are required to fulfill the [c]ommittee [m]andate.'"). This conclusion was erroneous.

When a term like "provide" has multiple definitions, Delaware courts look to "surrounding words" to determine the correct meaning. *Tetragon Fin. Grp. Ltd. v. Ripple Labs Inc.*, 2021 WL 1053835, at *4 (Del. Ch. Mar. 19, 2021). Even if the Chancery Court's interpretation of "provide" was reasonable in isolation, the Chancery Court was incorrect that "[t]he Resolutions did not identify the Special Committee, or anyone else, as the source of approval." *Id.* [redacted] Based on the surrounding words, the Chancery Court's interpretation that the Special Committee was to "procure" final approval from some other source was not reasonable on the motion to dismiss.

The Special Committee's power to approve the amendment is not qualified in the Resolutions by the requirements of the LTIPs or subject to stockholder approval. If the Board intended the Special Committee's approval power to be subject to potentially seeking approval from stockholders, it could have said so.[5] Instead, it

[5] For example, the Board could have provided approval power "subject to approval by the stockholders if required." *See, e.g., In re WeWork Litig.*, 250 A.3d 976, 998–99 (Del. Ch. 2020) (resolutions creating Special Committee stated, "a

granted the Committee the power to approve the amendment without any mention of the terms of the LTIPs or being subject to stockholder approval if necessary. The Resolutions give broad powers to the Special Committee, including complete authority to evaluate, negotiate, and approve the Proposed Amendment. Nothing in the Resolutions contemplates the Committee needing sign off or further approval by any other body. It was not reasonable for the Chancery Court to interpret the Resolutions as impliedly subjecting the Committee's approval power to further approval by stockholders.

2. The Board Lacked The Power To Finally Approve The Ema Amendment And Wrongfully Delegated Such Authority To The Special Committee

As the Chancery Court properly credited, the Complaint pleads with particularity that the EMA Amendment was a second, separate modification to equity awards not part of the spinoff. A046-48, ¶¶59, 61, A072, ¶¶101-02, A090-91, ¶¶132-34, A099, ¶153. The relevant accounting standards applied to the facts support the pleading stage inference that the EMA Amendment was a separate modification. A049-52, ¶¶66-72, A096-99, ¶¶148-53. In addition to the accounting rules, commonsense supports Plaintiff's allegations. The LTIPs prohibit the

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determination or recommendation by the Special Committee to adopt or approve the consummation of a Potential Transaction shall be subject to approval by the Board and, if required by law or regulation, by the Company's stockholders.").

retroactive modification of equity grants to select a favorable price for recipients, and the purported basis for the conclusion that the EMA Amendment was to account for the spinoff is internally inconsistent and lacks credibility. Thus, the Board was required to obtain stockholder approval.

The Complaint's particularized facts and the accounting analysis satisfy Rule 23.1. *See, e.g.*, *Ryan v. Gifford*, 918 A.2d 341, 355 (Del. Ch. 2007) (demand excused where complaint alleged specific grants, specific language of compensation plans, specific public disclosures, and supporting analysis suggestive of backdating); *Conrad v. Blank*, 940 A.2d 28, 34,35 (Del. Ch. 2007) (demand excused where complaint alleged company had used incorrect measurement dates for options grants, in violation of stockholder approved compensation plan, supported by plaintiff's own analysis of dates and prices of options grants). In *Coulter*, 2002 WL 31888343, at *11, demand was excused where plaintiff alleged defendants repriced specific options in violation of a compensation plan that required stockholder approval for repricings. The court explained:

> *Quite naturally, the parties disagree whether the repricings constituted a "change" to the exercise price. One plausible answer is that they did.* Thus, plaintiff alleges with particularity that repricing of directors' options in 1997 and 1999 was ultra vires. Any action of the board that falls outside the rather broad scope of its authority is not entitled to the protection of the business judgment rule and demand is excused.

Id. (emphasis added).

Here, the parties dispute the same issue as in *Coulter*: whether the EMA Amendment was a repricing requiring stockholder approval under the LTIPs. Defendants' argument that it was not relies on the assertion that the EMA Amendment was part of the spinoff—an assertion that contravenes well-pled facts and inferences in Plaintiff's favor at the pleading stage. Properly rejecting Defendants' baseless assertion at the pleading stage, the EMA Amendment was a separate modification, which required stockholder approval. The requirement of stockholder approval means that the Board lacks authority to finally approve the EMA Amendment, thus the Board exceeded its authority by granting the Special Committee with the power to finally approve the EMA Amendment.

As in *Coulter*, Plaintiff and Defendants offered "unsurprisingly, different views about the correct construction" of the compensation plan at issue. *Coulter*, 2002 WL 31888343, at *11. As in *Coulter*, Plaintiff's interpretation is "plausible," and it is undisputed that the modifications were adopted "without additional shareholder approval." *Id.* As in *Coulter*, demand is excused because "[a]ny action of the board that falls outside the rather broad scope of its authority is not entitled to the protection of the business judgment rule." *Id*.

a) The EMA Amendment Was A Separate Modification To Equity Awards Not In Connection With The Spinoff

The EMA Amendment had a different grant date, different purpose, and different transaction structure and affected different awards than the Conversion. It was a separate modification of the equity awards and required stockholder approval.

The grant date for the Conversion and the grant date for the EMA Amendment were different, evidencing the disparate modifications. ASC 718-20 provides that the grant date for an equity award is the date when the Company and the award recipient reach a mutual understanding of the key terms and conditions and when the requisite approvals have been obtained. A050-51, ¶¶69-70. PwC's own Stock-Based Compensation Guide applies the same principles to determine the modification date for equity awards. A050-51, ¶¶69-70. [redacted]

[redacted]The terms of the EMA Amendment were not public until May 29, 2020, and as a result, there was no mutual understanding of the modified terms of the awards affected by the EMA Amendment until long after the spin had closed. *Id*. Similarly, RTX was not contingently obligated to grant the recipients of awards modified by the EMA Amendment additional equity awards until [redacted], when the EMA Amendment was approved. *See* A051, ¶70 ("The grantor becomes

contingently obligated on the grant date to issue equity instruments . . . ."). By contrast, the terms of the Conversion were disclosed prior to the spinoff, the parties had a mutual understanding of the terms prior to the spinoff, and RTX was contingently obligated to grant those awards at close of the spin on April 3, 2020. A069, ¶97, A055, ¶78 n.5. Therefore, the grant date for the Conversion was April 3, 2020, whereas the grant date for the EMA Amendment was May 29, 2020.

The justification offered by the [redacted] for using the same grant date for the two modifications—that the EMA Amendment would [redacted] because the key terms were purportedly [redacted] is plainly insufficient under ASC 718-20. *See* A074-75, ¶107. Maintaining [redacted] was not a term or condition of the equity awards. The material terms and conditions of the equity awards related to exercise price and quantity, which are the very terms affected by the EMA Amendment. In any event, as demonstrated in the Complaint, the Conversion provided consistent value while the EMA Amendment conferred a windfall. *See* A090-91, ¶¶132-34.

[redacted]

the express purpose of the EMA Amendment differed from the purpose of the Conversion. The purpose of the Conversion was to correct the value of the awards

due to the spinoff itself. A073, ¶103. The purpose of the EMA Amendment was different: to adjust awards in response to facts that occurred *after* the spinoff had closed. A072, ¶102 (purpose was to correct for "market volatility" following the spinoff). The grant date for the EMA Amendment could not plausibly be the spinoff date when its express purpose was to address volatility that occurred after the spinoff date.

Supporting that the EMA Amendment was a separate modification and further demonstrating that the purported intent to maintain [redacted] was meaningless, the EMA Amendment applied only to a small subset of the awards modified by the Conversion. A086-87, ¶125. While the Conversion adjusted all equity awards issued by UTC, both vested and unvested, the EMA Amendment applied only to holders of unvested awards that following the spinoff were employed by RTX. A086-87, ¶125, A101, ¶156. [redacted]

The EMA Amendment benefitted only a small subgroup of the award holders

affected by the Conversion – reflecting that its terms and conditions, and its purpose (and therefore, its modification date) were different than those of the Conversion.

Contractually, the EMA Amendment was structured differently from the Conversion. The Conversion was a trilateral transaction that required acts by and agreement of RTX, Otis, and Carrier. A055-56, ¶79. After Otis and Carrier declined to enter a trilateral amendment to the EMA, RTX unilaterally approved the EMA Amendment. A085-86, ¶124. The difference in parties to the contract reflects that the EMA Amendment was inherently a different transaction than the Conversion.

In sum, the EMA Amendment conferred a windfall on RTX's executives, while the Conversion was designed to protect award holders from volatility and to approximate the true value of RTX post spin. A063-65, ¶¶87-89, A090-91, ¶¶132-34. With the benefit of hindsight, the Board and management identified a mechanism to manipulate the value of certain awards by choosing the lowest stock price to be used in the formula. At the time they did this, they knew the action they were taking would confer a significant windfall. A069, ¶97, A076, ¶108. [redacted] The EMA Amendment was not necessary to preserve equivalent value because, under

the Conversion, award holders received equivalent value. *See* A090-91, ¶¶132-34 (illustrative examples).

RTX's attempt to characterize the EMA Amendment as a retroactive modification in connection with the spinoff is nearly unprecedented. According to Harvard Business Review, there were 350 spinoffs valued at greater than $1 billion from 2000 to 2020.[6] Presumably, there were also hundreds of smaller spinoffs during those twenty years valued at less than $1 billion. Plaintiff has identified only two other instances between 2000 and 2020 of a company purporting to adjust the treatment of equity awards after the spinoff had closed.[7] In neither instance was the modification challenged in court. As a result, the public record is silent as to whether stockholder approval might have been required under the relevant compensation plans or the propriety of any accounting determinations. Regardless, only two other

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[6] Jeff Haxer, Dustin Rohrer, & Sam Rovit, *Research: Few Corporate Spinoffs Deliver Value*, Harvard Business Review, Dec. 20, 2022, https://hbr.org/2022/12/research-few-corporate-spinoffs-deliver-value.

[7] On April 1, 2020, Howmet Aerospace Inc. spun off Arconic Corporation, and ten days later amended the equity conversions in the spinoff. *See https://www.sec.gov/Archives/edgar/data/1790982/000110465920045599/tm2015610d1_8k.htm*. On March 4, 2016, The Manitowoc Company, Inc. spun off Manitowoc Foodservice, Inc. and on March 28, 2016 amended the equity conversions in the spinoff. https://www.sec.gov/Archives/edgar/data/61986/000006198616000083/mtw-20163298xk.htm.

companies have attempted an arguably similar modification over two decades and several hundred public spinoffs. At best, the Board's decision to characterize the EMA Amendment as part of the spinoff relies on a novel and untested accounting approach.

[redacted] – facts that are important considering that the accounting conclusion was highly unusual and was being used to circumvent stockholder approval and conceal the impact of a significant giveaway to executives.

Regardless, the EMA Amendment was materially different from the modification proposed in the memorandum,[8] [redacted] Even if the contents of the memorandum had some indicia of reliability, which they do not, the proposed

[8] [redacted]

accounting did not apply to the EMA Amendment as approved. The Board therefore had no good faith basis to believe that the EMA Amendment was not a repricing requiring stockholder approval under the LTIPs.

b) The LTIPs Unambiguously Required Stockholder Approval

For the purposes of the deciding Defendants' Rule 23.1 motion, the Chancery Court correctly accepted as true the Complaint's allegations that the EMA Amendment could not be accounted as though it occurred in the spinoff. The Chancery Court also correctly accepted as true for the purposes of the motion, that the Complaint adequately alleged that the LTIPs required stockholder approval. There is no dispute that stockholder approval was not sought or obtained.

c) Because The Board Gave The Special Committee Power To Approve The Amendment, Which It Lacked, The Delegation Exceeded Its Authority And Demand Is Excused

The Board did not have the power to finally approve the Proposed Amendment, only the stockholders did. The delegation of final approval power to the Special Committee therefore exceeded its authority and demand is excused. "Boards of directors have no discretion to exceed the intra-entity limitations on their authority." *Allen v. El Paso Pipeline GP Co., L.L.C.*, 90 A.3d 1097 (Del. Ch. 2014)). The Board's delegation of final approval power to the Special Committee therefore was not a valid exercise of business judgment. "Any action of the board that falls outside the rather broad scope of its authority is not entitled to the protection of the business judgment rule and demand is excused." *Coulter*, 2002 WL 31888343, at *11. As the *Garfield v. Allen* court explained:

> the business judgment rule only applies when directors make a discretionary judgment that falls within the scope of their authority. The business judgment rule does not protect a decision that exceeds the directors' authority. Instead, allegations that the directors knowingly exceeded their authority are sufficient to state a claim that the directors breached their duty of loyalty.

277 A.3d 296, 330–31 (Del. Ch. 2022); *Coulter*, 2002 WL 31888343, at *10 ("the business judgment rule may not be invoked to shelter unauthorized actions of a board of directors").

The Board's delegation of authority to the Special Committee to finally approve the EMA Amendment thus was a breach of fiduciary duty. *Ryan v. Gifford*, 918 A.2d 341, 354 (Del. Ch. 2007) (violation of an express term of an incentive compensation plan is a breach of fiduciary duty); *accord Conrad*, 940 A.2d at 40 (same). As in *Ryan*, "[t]he plans do not grant the board discretion to alter the exercise price by falsifying the date on which options were granted. Thus, the alleged facts suggest that the director defendants violated an express provision of two option plans and exceeded the shareholders' grant of express authority." 918 A.2d at 355. By falsely claiming that the EMA Amendment was part of the spinoff, the Board effectively falsified the date on which the options were granted to avoid the conclusion that the EMA Amendment was a repricing requiring stockholder approval. But for that subterfuge, it would have been clear for all to see that the Board had exceeded the stockholders' grant of express authority by the EMA Amendment to confer hundreds of millions of dollars on insiders. The Board members' action therefore excuse the necessity of pre-suit demand.

II. THE CHANCERY COURT ERRED BY DECLINING TO INFER THAT THE BOARD KNEW OF THE STOCKHOLDER APPROVAL REQUIREMENT IN THE LTIP

A. Question Presented

Whether demand is excused because knowledge is inferred from the Board's violation of the unambiguous stockholder approval term of the LTIPs and allegations demonstrating that a majority of the Board was responsible for administration of the LTIPs and otherwise actually aware of the stockholder approval requirement. *See* A193-202.

B. Scope of Review

The Court's review of decisions under Rule 23.1 is *de novo*. *Brehm*, 746 A.2d at 253-54.

C. Merits of Argument

The Complaint alleges that the Board made a decision: delegation of power to approve the EMA Amendment to the Special Committee. As argued above, the Chancery Court erred by disregarding Plaintiff's reasonable interpretation of the scope of those powers in favor of a less reasonable interpretation advanced by Defendants. The Chancery Court also erred by holding that even if the Board had delegated final approval power to the Special Committee, demand was not excused because the "Plaintiff's pleadings fatally undercut the position that the Board did so in knowing violation of the LTIPs." Letter Opinion, at 20. The Chancery Court

stated that while knowledge is inferred from a "plain and unambiguous violation" of "plain and unambiguous restriction on fiduciary's authority," that inference was not warranted here because the Complaint repeatedly alleged the Board did not consider the requirements of the LTIPs before delegating authority to the Special Committee. *Id*. This was error.

1. Knowledge Is Inferred When The Board Exceeded Its Authority By Violating The LTIPs

Courts infer knowledge if the allegations, taken as true, sufficiently allege that the Board violated a plain and unambiguous restriction in a stockholder approved compensation plan. *Garfield*, 277 A.3d at 322. Courts evaluating allegations raising a violation of stockholder approved compensation plans do so under two frameworks that yield the same result: a contract analysis or a bad faith analysis.

> Under both approaches, *the plan operates as a contract*. Indeed, for purposes of pleading-stage motion practice under Rules 12(b)(6) and 23.1, the choice between the two routes is usually trivial because, *when the complaint pleads that the directors violated a plain and unambiguous provision of an equity compensation plan, that fact supports an inference of bad faith* that renders demand futile as to the directors who approved the problematic awards.

Id. (emphasis added). In other words, the fact of violation of a plain and unambiguous provision of an equity compensation itself excuses demand. To the extent that knowledge is required to infer bad faith, it is inferred from the violation.

As demonstrated in the Complaint and above, the Board's delegation of final approval of the EMA Amendment to the Special Committee violates the LTIP. The provisions of the LTIPs requiring stockholder approval are plain and unambiguous. ¶59 ("In no event may any [SAR] or Stock Option granted under this Plan be amended, other than pursuant to Section 3(e) . . . unless such amendment, cancellation or action is approved by the Corporation's shareholders."); ¶61(similar). The modifier "in the event of a spinoff" does not render the provision ambiguous because the spinoff had already occurred [redacted] to the Board's creation of a Special Committee to consider the EMA Amendment.

The Chancery Court erred by failing to infer knowledge from the violation the express limitation in the LTIPs. "[W]hen a plaintiff presents particularized factual allegations that indicate that the board clearly violated an unambiguous provision of a stock plan, it is proper to infer that such violation was committed knowingly or intentionally and, therefore, that demand should be excused." *Pfeiffer v. Leedle*, 2013 WL 5988416, at *6 (Del Ch. Nov. 8, 2013). The question is not whether allegations of knowledge are sufficient; it is whether the allegations show that a plain and unambiguous provision of the plan was violated.[9] The correct analysis looks to

[9] *See also Garfield*, 277 A.3d at 331 (Where, as here, "the allegations of a complaint support a reasonable inference that a fiduciary violated a plain and unambiguous restriction on the fiduciary's authority, then the plaintiff has asserted a

whether there was a violation of an express limitation, which gives rise to an inference of knowledge. *See e.g., id* ("The loyalty violation in that setting is the failure to act in good faith to comply with pertinent legal obligations. *In the face of a plain and unambiguous restriction on the fiduciary's authority, it is reasonable to infer that the fiduciary violated the restriction knowingly*." (emphasis added)); *Pfeiffer*, 2013 WL 5988416, at *9 ("[A] *prima facie* showing of such a clear violation supports an inference that the [b]oard *either knowingly or deliberately* exceeded its authority. Knowing or deliberate violations of a stockholder approved stock plan implicate the duty of loyalty, and breaches of the duty of loyalty cannot be exculpated by a charter provision adopted pursuant to 8 *Del. C.* §102(b)(7)."). The Chancery Court's requirement of allegations of knowledge of the violation, therefore, was error.

2. A Majority Of The Board Either Knew Of The Stockholder Approval Requirement In The LTIPs Or Received The Benefits Of The EMA Amendment

The Chancery Court erroneously concluded that an inference of knowledge was unsupported because the Complaint alleges the Board minutes do not reflect

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claim for a breach of the duty of loyalty that rebuts the protections of the business judgment rule.").

consideration of the terms of the LTIPs. Letter Opinion, at 20. The Board was responsible for administration of the LTIPs and for seeking stockholder approval when necessary. Under the Chancery Court's reasoning, the Board can blamelessly remain ignorant of the terms of the LTIPs that it is responsible for administering. The Chancery Court's approach would give Boards an incentive not to consider the requirements of a stockholder approved plan to avoid potential liability for its violation.

At most, courts require Board knowledge of the existence of the relevant provision. *See Pfeiffer*, 2013 WL 5988416, at *10 n.59 ("At a minimum, [fiduciary] received, and was charged with knowledge of, the Plan's contents when he was awarded his Stock Options."); *accord California Pub. Employees' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *11 (Del. Ch. Dec. 18, 2002) (denying motion to dismiss where plaintiff alleged that the violation of the compensation plan was "undertaken without the exercise of *any* business judgment." (emphasis in original)). The Chancery Court's approach here would lead to the absurd result that by simply burying its head in the sand a Board would be immunized from liability for any potential violation of a stockholder approved plan.

Properly evaluating whether the facts supported an inference that the Board knew of the approval requirement, demand is excused. The entire Board was

responsible for seeking stockholder approval under the plan, and knowledge is inferred from the violation of a clear and unambiguous term. Even if knowledge of the stockholder approval requirement were only inferred as to directors on the Compensation Committee who directly oversaw administration of the LTIPs and the directors who issued the 2018 Proxy Statement soliciting approval of the UTC 2018 LTIP, demand would be excused.

a) The Entire Board Knew Of The Stockholder Approval Requirement Because It Was Responsible For Administration Of The LTIPs

Knowledge of the stockholder approval requirement is reasonably inferred because the Complaint repeatedly alleges that the Board was ultimately responsible for administration of the LTIPs. A034-35, ¶¶12-14, A044, ¶52, A102, ¶159. The Board repeatedly told stockholders that it was responsible for administering the LTIPs. As the party responsible for administration of the LTIPs, the Board could not in good faith have been unaware of the stockholder approval requirement, and the reasonable inference is that it was.

b) Even If Knowledge Is Inferred As To The Directors Who Directly Administered The LTIPs And Solicited Approval Of The UTC 2018 LTIP, A Majority Of The

Demand Board Knew Of The Stockholder Approval Requirement

The demand board consisted of thirteen directors, and a majority of them knew of the stockholder approval requirement. Two directors (Hayes and Ortberg) are undisputedly interested,[10] four directors were on the UTC board when it issued the 2018 proxy statement (Larsen, Reynolds, O'Sullivan, and Rogers), and one additional (Ramos) director was on the Compensation Committee tasked with overseeing administering the plan, making seven of thirteen unable to disinterestedly consider demand.

Four directors of the Demand Board (Larsen, O'Sullivan, Reynolds, and Rogers) solicited approval of the UTC 2018 LTIP. When the Board solicited approval of the UTC 2018 LTIP in UTC's 2018 Proxy Statement, it claimed the plan had "features . . . to protect shareowners' interest and mitigate potential risk," specifically including: "[n]o stock appreciation right or stock option repricing without shareowner approval." A048, ¶64. These four directors have requisite knowledge because they solicited stockholder approval of the provision that Plaintiff

[10] In their motion to dismiss briefing, Defendants conceded demand is excused as to Ortberg and Hayes. Letter Opinion, at 15 n.68 ("Defendants concede demand is excused as to directors Hayes and Ortberg, who owned significant unvested equity that were affected by the EMA Amendment and are thus not disinterested."); *see also Conrad,* 940 A.2d at 38 (directors who received awards issued in violation of equity plan not disinterested).

now claims was violated. *See, e.g.*, *Garfield*, at 335 (CEO had knowledge of plan terms because he was on the board when it sought approval of the plan in a proxy statement, which described the relevant provision as a "material term").

Though Ramos was not on the Board when the 2018 Proxy Statement was issued, she has served on the UTC Compensation Committee since December 2018 and, in that capacity, was responsible for overseeing administration of then LTIPs and recommending to the Board changes to incentive compensation that required stockholder approval. A038, ¶29, A044, ¶52. Therefore, she also has knowledge of the stockholder approval requirement.

CONCLUSION

The Letter Opinion granting Defendants motion to dismiss should be reversed.

Dated: October 8, 2024

By: */s/ Blake A. Bennett*

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