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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.

Case No. 347, 2024

Court Below:
Court of Chancery of the State of Delaware

C.A. No. 2022-1124-MTZ

[redacted]

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APPELLEES' ANSWERING BRIEF ON APPEAL

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[redacted]

[redacted]

John L. Reed (I.D. No. 3023)
Ronald N. Brown, III (I.D. No. 4831)
Peter H. Kyle (I.D. No. 5918)
DLA PIPER LLP (US)
1201 North Market Street, Ste. 2100
Wilmington, Delaware 19801
(302) 468-5700

Attorneys for Defendants 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, and Nominal Defendant RTX Corporation

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NATURE OF PROCEEDINGS

This derivative action challenges an amendment to employee-compensation awards adopted by a special committee of three independent directors of RTX Corporation. Plaintiff made no pre-suit demand. When the complaint was filed, RTX's board had thirteen members. For seven of these directors, plaintiff's only allegation of demand futility is that they were members of the board that delegated its authority to the special committee. Plaintiff makes no allegation that these seven directors lacked independence or received any material personal benefit from the challenged employee-compensation amendment. An eighth director is not a defendant and faces no allegations of demand futility at all.

The Court of Chancery dismissed the case under Rule 23.1 for failure to make pre-suit demand. Applying this Court's precedent in *United Food & Commercial Workers Union* v. *Zuckerberg*, 262 A.2d 1034 (Del. 2021), the Court of Chancery held that demand on independent, disinterested directors can be excused only through particularized allegations that they face a substantial likelihood of *non-exculpated* liability—*i.e.*, that they acted in bad faith. Plaintiff failed to plead that the seven directors who delegated the board's authority to the special committee acted in bad faith, the court held, for two independent reasons:

[redacted]

First, the court rejected plaintiff's argument that the delegation itself constituted a decision about whether stockholder approval was required under the governing equity-compensation plans. The plain text of the resolutions delegating the board's authority contain no such decision. The board delegated all of its authority over a potential amendment to the special committee, which could decide whether and how to provide any approval for such an amendment.

Second, the complaint alleges that, before approving the delegation to the special committee, the directors did not "consider whether the plans required stockholder approval for the modification," "[n]or did they determine that stockholder approval was not required." A103, ¶ 160.[1] The court held that these allegations foreclosed any argument that the directors made a *knowing* decision to violate a stockholder-approval requirement in the plans, as would be needed to plead that they acted in bad faith and thus face a non-exculpated claim.

The Court of Chancery was correct on both points. Because a majority of the board at the time of suit could have considered a demand, dismissal under Rule 23.1 should be affirmed.

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[1] Citations in the form "¶ __" refer to the Verified Amended Stockholder Derivative Complaint (the "complaint"). *See* A008, Dkt. 11.

SUMMARY OF ARGUMENT

1. **Denied.** Demand is not excused because a majority of the thirteen-member board at the time of the complaint faces no substantial likelihood of liability on a non-exculpated claim. As to seven directors, plaintiff's only allegation of demand futility is that they delegated to a special committee the board's authority over a potential amendment to employee-compensation awards. No precedent supports the proposition that directors who did not approve a challenged transaction can still face non-exculpated liability for delegating their approval authority to a committee, as Delaware law permits.

Plaintiff is wrong that the delegation itself constituted a decision that stockholder approval would not be required for the potential amendment. As the Court of Chancery held, the board's delegating resolutions included no decision about whether the special committee would require stockholder approval if it sought to adopt the amendment. Because the seven delegating directors made no decision on this issue, they cannot face non-exculpated liability for such a decision. The Court of Chancery was correct to interpret the plain text of the board resolutions on a motion to dismiss.

Even if, contrary to the resolutions, the seven delegating directors had somehow made a decision about stockholder approval, that decision would not

[redacted]

expose them to a substantial likelihood of non-exculpated liability. The plans allowed the board to make adjustments to employee-compensation awards without stockholder approval in the circumstances at issue. Plaintiff's argument that these directors acted in bad faith by committing a plain and unambiguous breach of the plans would thus fail even if they had made the challenged decision.

2. **Denied.** The Court of Chancery correctly held, as an independent ground for dismissal, that plaintiff's allegations defeat the inference that these seven directors decided to forego stockholder approval in knowing violation of the governing equity-compensation plans. The complaint alleges that the full board did not consider, or make a determination about, the issue of stockholder approval before delegating to the special committee. The Court of Chancery properly credited these allegations on a motion to dismiss. Plaintiff cannot overcome its own allegations to show the bad faith required to excuse demand.

STATEMENT OF FACTS

A. The UTC compensation plans.

Before April 2020, United Technologies Corporation ("UTC") operated in the aerospace, air conditioning, and elevator industries. A52, ¶ 73. Like many public companies, UTC issued equity awards to certain employees as part of their compensation. A031, A055-56, ¶¶ 4, 79. These awards included stock options and stock appreciation rights ("SARs"). A045, ¶ 55. Award holders were given the opportunity to benefit from increases in the price of UTC's stock if it rose above an "exercise price" set when the awards were granted. *See* A046-48, ¶¶ 59, 61.

UTC issued awards under two contracts, known as long-term incentive plans or "LTIPs": a 2014 plan (the "UTC LTIP") and a 2018 plan (the "UTC 2018 LTIP"). A044, ¶ 54; B001-10; B011-22. The LTIPs provided that they would be administered by UTC's full board, its compensation committee, "or such other committee of the Board as the Board may from time to time designate." B011 at § 2(i); B013 at § 3(a); *see also* B001 at § 1(k); B003 at § 2(a); A045, ¶ 56.

The LTIPs granted the board or the designated committee discretion to adjust awards if UTC engaged in spinoffs, mergers, and other corporate transactions. Section 10(b) of the UTC LTIP provided that, "[i]n the event" of such transactions, "the Committee or the Board may in its discretion make such

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substitutions or adjustments as it deems appropriate and equitable to … (iii) the number and kind of Shares or other securities subject to outstanding Awards; and (iv) the exercise price of outstanding Options and Stock Appreciation Rights." B017 at § 10(b); *see also* A047, ¶ 60. Section 3(e) of the UTC 2018 LTIP contained a similar grant of discretion. B004 at § 3(e)(ii); *see also* A045-46, ¶ 58. Other provisions of the LTIPs required stockholder approval for certain amendments to awards, but they excepted the transaction-related adjustments that the board or designated committee could make under Sections 10(b) and 3(e), respectively. *See* B014 at § 5(c) (requiring stockholder approval for certain amendments, "other than pursuant to Section 10"); B005 at § 5(c) (same, "other than pursuant to Section 3(e)"); A047-48, ¶ 61; A046-47, ¶ 59.

B. UTC separates into three independent companies and determines how to adjust outstanding equity awards.

In November 2018, UTC announced spinoffs of its air conditioning business (Carrier) and elevator business (Otis) into separate independent public companies. A052, ¶ 73. In June 2019, UTC announced a merger of its remaining aerospace businesses with Raytheon Company, forming what is now RTX. A053, ¶ 74.

In anticipation of these transactions, UTC's compensation committee considered how to convert outstanding UTC awards into awards of the three post-transaction public companies. The committee developed a methodology that

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would adjust both the number of outstanding awards and the exercise prices of SARs and stock options. *See* A059-66, ¶¶ 82-91. The methodology was based on a comparison of UTC's pre-transaction stock price to post-transaction Carrier, Otis, and RTX prices. *See* A056, ¶ 80. The committee chose to measure the new prices using a "volume-weighted average price" or "VWAP" over the fourth and fifth trading days after the transactions closed. A055-56, A061, A063-64, ¶¶ 79-80, 84, 87.

The adopted conversion formula was memorialized in an April 2, 2020 Employee Matters Agreement (the "EMA") among UTC, Carrier, and Otis. B023-69; *see* A055-56, ¶ 79 & n.6.

C. The transactions close amidst significant market volatility, yielding unanticipated results in award conversions.

The spinoffs and merger closed before the market opened on April 3, 2020. A066, ¶ 92. This date was early in the COVID-19 crisis, "during a period of pronounced market volatility." B092. Along with the rest of the market, UTC's stock price had fallen precipitously over the preceding weeks—down about 43%. *Id.* Over the few days after the transactions closed, however, the markets turned positive, and the prices of RTX, Carrier, and Otis all rose. A066, ¶ 92; B074. Measured using a "VWAP" on their fourth and fifth trading days, the aggregate price of these stocks was thus significantly higher than UTC's price immediately

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before closing. A066, ¶ 92. As a result, the compensation committee's selected adjustment methodology resulted in employees receiving fewer awards at higher (*i.e.*, less favorable) exercise prices than they would have if market prices had remained flat or fallen. *See* B077-78.

D. The new RTX board forms a special committee to consider amending the adjustment methodology for employee awards.

On April 27, 2020, the board of the new post-merger RTX met to discuss the [redacted] and the impact on employee "retention, morale and incentives." B189; *see also* A066-67, ¶ 93. At the meeting, the board received advice from several outside advisors. Financial advisors presented data showing that the five-day share price movement after the UTC spinoffs was far higher than in precedent transactions. B091-93. External legal counsel also reviewed for the board a potential amendment of the EMA to address the volatility. B190; *see also* B094-95. The amendment proposed to replace the multiday "VWAP" with a formula tied to the RTX, Carrier, and Otis opening stock prices on the day the transactions closed—a total price within 1% of UTC's pre-transaction price, resulting in a more favorable adjustment for employees. A069, ¶ 97; B094-95. Counsel informed the board that they had consulted with representatives of the New

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York Stock Exchange, who indicated that such an amendment would not require stockholder approval under NYSE Rules. A078, ¶ 112; *see* B106; B189.

At the April 27 meeting, the board also discussed accounting issues relating to a potential amendment. *See* A070-78, ¶¶ 99-111; *see also* B094-98; B292. RTX's general counsel and CFO presented an accounting memorandum explaining that an amendment [redacted] —*i.e.*, the EMA and its potential amendment would constitute a single modification for accounting purposes. B096-97; A069-70, A072, A124, ¶¶ 98, 102, 107. The memorandum stated that management had "[redacted]" with RTX's auditor, PricewaterhouseCoopers LLP ("PwC"), which "[redacted]" B098; A073-74, ¶¶ 103-04.

After receiving these presentations, the board adopted resolutions establishing "[redacted]" B190; *see also* A031,

[redacted]

¶ 6. The resolutions gave the special committee "all the powers and authority of the Board in connection with" a broad "Committee Mandate," defined as follows:

> (a) reviewing, analyzing and evaluating the Potential Amendment, (b) overseeing the negotiation of the terms and conditions of the Potential Amendment, (c) determining whether the Potential Amendment (and any related agreements or other documentation) is in the best interests of the Corporation and its shareowners and (d) providing final approval for the Potential Amendment (and any related agreements or other documentation) and related matters if they are determined to be in the best interests of the Corporation and its shareowners (the purposes (a) through (d), the "Committee Mandate").

B198-99; *see also* A043, ¶ 51. The resolutions also authorized the special committee to "undertake all actions that, in the determination of the Committee, are required to fulfill the Committee Mandate" and to "take such other actions, as the Committee determines necessary, appropriate or advisable in connection with any and all aspects of the Potential Amendment." B198-99.

The board appointed three directors to the special committee: Tracy Atkinson, Dinesh Paliwal, and James Winnefeld, Jr. B198; A039, A095-96, ¶¶ 34, 146. Each had previously served on the Raytheon Company board and thus was not affiliated with UTC, the legacy company whose employees' awards were at issue. *See* A037-39, ¶¶ 20, 27, 32. The board determined that each committee

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member was "independent and disinterested with respect to the Potential Amendment." B198.

E. The special committee considers and approves amending the adjustment methodology for employee awards.

The special committee met three times to consider whether to amend the EMA. *See, e.g.*, B237-40; B241-47; B248-254. Outside counsel and representatives from an executive compensation consulting firm attended each meeting. *See* B237; B241; B248. [redacted] B249-50. [redacted] B239. [redacted] B278. After reviewing these issues—[redacted] B292—the special committee determined that amending the EMA to replace the VWAP formula was [redacted]" B251.

The special committee's resolutions approving the amendment stated that [redacted]

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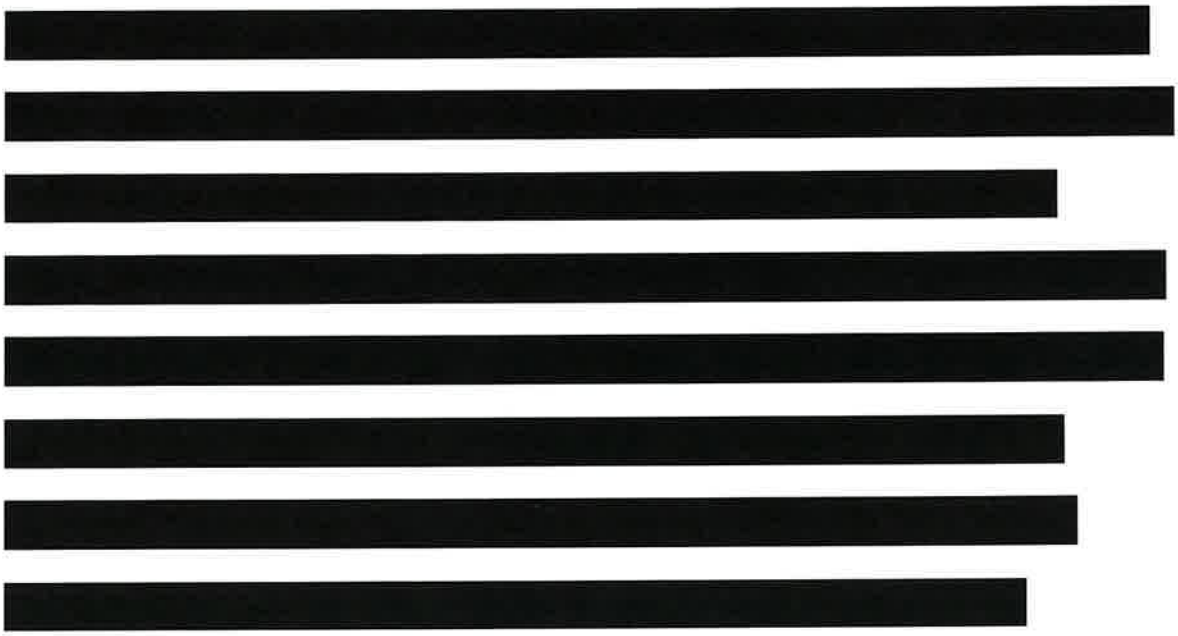

On May 29, 2020, RTX filed the EMA Amendment publicly as an exhibit to a Form 8-K. B310-15; A088-89, ¶ 129.

F. Plaintiff files suit without making a pre-suit demand.

On December 6, 2022, plaintiff filed a complaint without making a pre-suit demand. A001, Dkt. 1. The complaint incorporated certain documents that RTX had produced under 8 *Del. C.* § 220.

At the time of the complaint, RTX's board had thirteen members (the "Demand Board"). A094, ¶ 144. Only two were employees of RTX: Gregory Hayes, the CEO, and Robert (Kelly) Ortberg, a special advisor to the CEO. A037-38, ¶¶ 19, 25. The remaining eleven were all independent, non-management directors.

Bernard Harris, Jr. joined the RTX board in April 2021, after the events at issue but before the case was filed. A040, ¶ 38. He is not named as a defendant, and the complaint does not allege that demand on him is excused. *See* A039, A093-103, ¶¶ 34, 141-61.

Seven independent directors were on the board at the time of the EMA Amendment but did not serve on the special committee that approved it. George Oliver, Ellen Pawlikowski, and Robert Work had been directors of Raytheon Company before the merger, while Margaret O'Sullivan, Denise Ramos, Frederic Reynolds, and Brian Rogers had been directors of UTC. A037-39, ¶¶ 24, 26, 28-31, 33. Ramos, Reynolds, and Rogers were also members of RTX's compensation committee. A038, ¶¶ 29-31.

As noted, the three members of the special committee (Atkinson, Paliwal, and Winnefeld) had all been Raytheon Company directors. A037-39, ¶¶ 20, 27, 32, 34. All three also served on RTX's compensation committee, which Atkinson chairs. *Id.*

G. The Court of Chancery dismisses the complaint with prejudice under Rule 23.1.

On February 27, 2023, defendants moved to dismiss the initial complaint under Rule 23.1. A003, Dkt. 6. Plaintiff responded with an amended complaint, which asserted three claims against the RTX directors serving at the time of the EMA Amendment: (i) breach of fiduciary duty; (ii) unjust enrichment (against the

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two management directors only); and (iii) waste. A008, Dkt. 11; A104-06, ¶¶ 162-74. Defendants again moved to dismiss under Rule 23.1. A009, Dkt. 15; A110-53.

On July 23, 2024, the Court of Chancery dismissed the case with prejudice. Op. at 23; Pl. Br. at Ex. 1 (Order). The court focused its analysis on the seven defendant directors who did not serve on the special committee, as they comprised a majority of the Demand Board. Op. at 15. Because RTX's certificate of incorporation exculpates directors to the fullest extent permitted by Delaware law, *see* B329, the court held that plaintiff was required to plead bad faith conduct by these seven directors to excuse demand, Op. at 15. The court considered and rejected plaintiff's argument that the directors acted in bad faith by "determin[ing] that stockholder approval was not necessary" in violation of the LTIPs and by "delegating authority for final approval of the EMA Amendment to the Special Committee, which [is] authority the Board lacked." *Id.* at 17 (alteration in original). The court concluded that plaintiff's "theory falters in two places: that the Board made any decision at all about stockholder approval, and that the Board did so in bad faith." *Id.*

On the issue of the board's decision, the Court of Chancery based its conclusion on the plain text of the RTX board resolutions delegating authority to the special committee. *Id.* at 18-19. Reading the resolutions as a whole, the court

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noted that the committee had authority to "provid[e] final approval" for the potential amendment; to "undertake all actions that, in the determination of the [c]ommittee, are required to fulfill the [c]ommittee [m]andate"; and "[t]o take such other actions, as the [c]ommittee determines necessary, appropriate or advisable in connection with any and all aspects of the [p]otential [a]mendment." *Id.* (alterations in original). These broad grants of authority gave the committee "flexibility" to "procure final approval by seeking stockholder approval if it so chose." *Id.* Accordingly, plaintiff did not plead that "the Board decided approval should come from the Special Committee." *Id.* at 19.

On the issue of bad faith, the court held that—even if the board had decided to forego stockholder approval—plaintiff's own "pleadings fatally undercut the position that the Board did so in knowing violation of the LTIPs." *Id.* at 20. The complaint pleaded, among other things, that "neither the full Board nor the Compensation Committee even discussed the requirements of the UTC LTIPs"; that "[t]he Board never expressly considered or decided whether the EMA Amendment would, or even could, require shareholder approval under the LTIPs"; and that the board did not "consider whether the plans required stockholder approval for the modification," "[n]or did they determine that stockholder approval was not required." *Id.* (alterations in original) (quoting A103, ¶ 160; A199).

[redacted]

Accordingly, "[t]aking Plaintiff at its word, the Board made no determinations concerning the EMA Amendment, and certainly none that were deliberately and knowingly in violation of the LTIPs." *Id.* at 20; *see also id.* at 22 ("Plaintiff has pled knowledge was wholly absent.").

Because plaintiff did not plead that the board knowingly exceeded its authority by choosing not to seek stockholder approval for the EMA Amendment, the Court of Chancery concluded, plaintiff failed to plead the bad faith of seven directors—a majority of the Demand Board. *Id.* at 23. Demand was thus not excused. *Id.*

[redacted]

ARGUMENT

I. DEMAND IS NOT EXCUSED BECAUSE A MAJORITY OF THE DEMAND BOARD MADE NO CHALLENGED DECISION.

A. Question Presented

Did the Court of Chancery correctly hold that demand is not excused because a majority of the Demand Board made no challenged decision and thus faces no substantial likelihood of liability?

B. Scope of Review

The dismissal of a complaint for failure to satisfy the particularized pleading standard of Court of Chancery Rule 23.1 is reviewed *de novo* by this Court. *Brehm* v. *Eisner*, 746 A.2d 244, 253-54 (Del. 2000).

C. Merits of Argument

The decision whether "to initiate or to refrain from initiating legal actions asserting rights held by the corporation" belongs to the corporation's board of directors. *White* v. *Panic*, 783 A.2d 543, 550 (Del. 2001) (citing 8 *Del. C.* § 141(a)). To "divest the directors of their authority to control the litigation asset and bring a derivative action on behalf of the corporation, the stockholder must (1) make a demand on the company's board of directors or (2) show that demand would be futile." *Zuckerberg*, 262 A.3d at 1047 (internal quotation marks omitted). Demand is "not excused lightly." *Id.* at 1049. Rule 23.1 imposes

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"stringent requirements of factual particularity that differ substantially" from "permissive notice pleadings." *Brehm*, 746 A.2d at 254. Plaintiff cannot rely on "[c]onclusory allegations" or "inferences that are not objectively reasonable." *Wood* v. *Baum*, 953 A.2d 136, 140 (Del. 2008).

When assessing allegations of demand futility, this Court must determine, "on a director-by-director basis":

> (i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;
>
> (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and
>
> (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

Zuckerberg, 262 A.3d at 1059. To excuse demand, one of these questions must be answered "'yes' for at least half of the members of the demand board." *Id.*

The Court of Chancery correctly dismissed the complaint because it fails to plead, with the particularity required by Rule 23.1 or otherwise, that a demand on a majority of the Demand Board would have been futile.

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1. Demand can be excused only if a majority of the Demand Board faces a substantial likelihood of liability on a non-exculpated claim.

As the Court of Chancery held, "[r]eaching half" of the thirteen-member Demand Board in this case turns on whether plaintiff pleads that demand is excused for each of the seven independent directors who did not serve on the special committee (Oliver, O'Sullivan, Pawlikowski, Ramos, Reynolds, Rogers, and Work). Op. at 15. The complaint pleads nothing at all to suggest that any of these seven directors received a material personal benefit from the challenged employee-compensation amendment or lacked independence from someone who did. Instead, the complaint's only allegation of demand futility as to any of these directors is that they face liability for a "breach of fiduciary duties." A103, ¶ 161. The Court of Chancery thus applied the second prong of *Zuckerberg* to plaintiff's demand-futility allegations. *See* Op. at 15 (citing A178-79).[2]

On this appeal, plaintiff does nothing to challenge the court's application of the governing law of demand futility. Plaintiff's appeal brief mentions neither *Zuckerberg* nor any director's "substantial likelihood of liability." The Court of Chancery's uncontested application of this law was correct.

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[2] Plaintiffs do not dispute that an eighth director on the Demand Board, non-defendant Harris, also could have considered a demand. Op. at 15 n.68.

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Because RTX has a § 102(b)(7) exculpatory provision, *see* B329, *Zuckerberg* dictates that a "substantial likelihood" of liability exists only when plaintiff pleads a *non-exculpated* claim. *Zuckerberg*, 262 A.3d at 1057, 1060; Op. at 15; *see also Wood*, 953 A.2d at 141. As the Court of Chancery held, pleading a non-exculpated claim in the circumstances of this case requires particularized facts demonstrating that the seven directors at issue acted in bad faith. Op. at 15. This Court has described the pleading standard as requiring "subjective bad faith," meaning that "plaintiff must plead with particularity that the directors acted with scienter." *McElrath* v. *Kalanick*, 224 A.3d 982, 991 (Del. 2020) (internal quotation marks and citation omitted). Pleading such scienter requires facts showing that the director "acted inconsistent with his fiduciary duties and, most importantly, that the director *knew* he was so acting." *Id.* at 991-92 (internal quotation marks and citation omitted). Accordingly, "a showing of bad faith in the context of demand excusal is a high hurdle, and essentially requires the plaintiff to demonstrate intentional wrongdoing by the board." *Id.* at 993.

Despite failing to address any of this governing law, plaintiff does not appear to contest that it was required to plead bad faith. *See, e.g.*, Pl. Br. at 27 (characterizing question on appeal as "[w]hether pre-suit demand is excused because the Board … acted in bad faith"). The complaint comes nowhere near

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meeting this "high hurdle" as to any director, much less the required majority of the Demand Board. *McElrath*, 224 A.3d at 993.

2. A majority of the Demand Board does not face a substantial likelihood of liability because they made no decision about the EMA Amendment or stockholder approval.

The Court of Chancery began its analysis under *Zuckerberg*'s second prong by asking if any of the seven directors at issue made a decision that plaintiff challenges. Op. at 17 (assessing whether "the Board made any decision at all about stockholder approval"). This was the correct question for the court to ask. A director can only be subject to personal liability when that individual has done something that is subject to fiduciary challenge. As this Court has held, "each director has a right to be considered individually when the directors face claims for damages in a suit challenging board action." *In re Cornerstone Therapeutics, Inc. S'holder Litig.*, 115 A.3d 1175, 1182 (Del. 2015). *Zuckerberg* thus requires "director-by-director" analysis. 262 A.3d at 1059.

It has long been Delaware law that even directors who do approve a challenged transaction are not thereby disqualified from considering a demand: "mere directorial approval" is not sufficient. *See, e.g.*, *Wood*, 953 A.2d at 142 n.18 (quoting *Aronson* v. *Lewis*, 473 A.2d 805, 814 (Del. 1984)). Thus, in *Zuckerberg*, this Court held that directors who approved a transaction—even an entire-fairness

transaction with a controlling stockholder unlike anything at issue here—could consider a demand absent plaintiff's pleading "with particularity facts establishing that a majority of the directors" were "subject to an influence that would sterilize their discretion with respect to the litigation demand." 262 A.3d at 1056.

If allegations that a director *approved* a challenged transaction are insufficient to excuse demand, plaintiff's allegations here suffer from an even more fundamental flaw: the seven non-special committee independent directors *did not approve* the transaction at issue, the amendment of employee compensation awards under the EMA. In plaintiff's own words, these directors' "decision" was "delegation of power to approve the EMA Amendment to the Special Committee." Pl. Br. at 44; *see also* A034, ¶ 12 ("The Board had delegated authority to evaluate and approve the modification of equity awards to the Special Committee."). The DGCL "expressly empowers a board of directors to appoint committees and to delegate to them a broad range of responsibilities." *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 54 (Del. 2006) (citing 8 *Del. C.* § 141(c)); *see also Rosenblatt* v. *Getty Oil Co.*, 493 A.2d 929, 943 (Del. 1985) ("In setting its agenda as to the matters in which it will be directly involved, and those it will delegate, a board's decisions in those areas are entitled to equal consideration as exercises of business judgment."). Plaintiff can point to no precedent for the proposition that directors

[redacted]

who did not approve a challenged transaction can still face non-exculpated liability—that they can be accused of *bad faith*—for delegating their approval authority to a committee, as Delaware law permits.

The case can and should end here: a majority of the directors on the Demand Board were not the decisionmakers on the transaction that plaintiff challenges. The demand requirement exists for just such a situation. If plaintiff believed that the three directors on the special committee breached their duties, plaintiff could have asked the majority of directors who were not on that committee to review the committee's decision and determine whether any action was warranted. But plaintiff failed to make that required demand, and its case fails for that reason.

Plaintiff tries to escape this fatal flaw in its case by arguing that the board's delegation of authority to the special committee itself constituted a decision that stockholder approval would not be required for the EMA Amendment. The Court of Chancery held that this theory is contrary to the plain text of the board's resolutions delegating authority to the special committee, which are incorporated into the complaint. Op. at 17-19. This decision was correct.

On their face, the board's delegating resolutions include no decision about whether the special committee would require stockholder approval for the EMA

Amendment. B198-200. Those resolutions gave the special committee "all the powers and authority of the Board in connection with" a potential amendment. B199. The board did not purport to delegate any powers or authority that it lacked, including to act without any required stockholder approval. Moreover, the special committee was given broad decisionmaking authority: to "determine whether the Potential Amendment (and any related agreements or other documentation) is in the best interests of the Corporation and its shareowners"; to "approve the Potential Amendment … and related matters if they are determined to be in the best interests of the Corporation and its shareowners"; to "undertake all actions that, in the determination of the Committee, are required to fulfill the Committee Mandate"; and to "take such other actions, as the Committee determines necessary, appropriate or advisable in connection with any and all aspects of the Potential Amendment." B198, B199.

Nothing in the plain text of the resolutions precluded the special committee, as part of its broad authority over *whether* to approve any amendment, from deciding not to approve the amendment, or conditioning such approval on a stockholder vote. Because the special committee only had the "powers and authority of the Board," it could only make a board-level decision, which—as is always true when boards approve corporate transactions—may or may not be

subject to stockholder review depending on the form of the transaction and applicable legal requirements.

Indeed, the special committee did not interpret the resolutions as precluding it from considering any stockholder-approval requirements. The pleading record reflects that, [redacted] B249-50. And when the committee approved the EMA Amendment, its own resolutions recited why doing so was within the LTIPs' grant of board-level authority to adjust awards in the event of corporate transactions: "[redacted]" B252. Treating the board's delegation as somehow pre-deciding for the committee that it could not consider the issue of stockholder approval—and that the board made this decision *in bad faith*—is not compatible with this record before the Court of Chancery on the motion to dismiss.

Plaintiff's criticisms of the Court of Chancery's reading of the board's delegating resolutions are without merit. *First*, plaintiff contends that the board

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defined the "Committee Mandate" to include "providing final approval for the Potential Amendment," while giving the committee power to determine whether "[t]o approve the Potential Amendment and related matters if they are determined to be in the best interests of the corporation and its shareholders." Pl. Br. at 28 (quoting A043, A079, ¶¶ 51, 113). The Court of Chancery concluded that these words were not a decision by the board about whether stockholder approval would be required: "provide" can mean "procure" or "supply," and the special committee "could procure final approval by seeking stockholder approval if it so chose." Op. at 19.

Plaintiff argues that the court's interpretation ignored plaintiff's own "reasonable" reading, based on "surrounding words," that the special committee's approval authority was not subject to stockholder approval. Pl. Br. at 29-31. But it is plaintiff's interpretation that is unreasonable because it fails to read the resolutions "as a whole," giving "each provision and term effect." *Weinberg* v. *Waystar, Inc.*, 294 A.3d 1039, 1044 (Del. 2023) (quoting *Manti Hldgs., LLC* v. *Authentix Acquisition Co., Inc.*, 261 A.3d 1199, 1208 (Del. 2021)). The board gave the special committee a mandate that included "overseeing the negotiation of the terms and conditions of the Potential Amendment," as well as the power to "undertake all actions that, in the determination of the Committee, are required to fulfill the Committee Mandate" and to "take such other actions, as the Committee determines necessary, appropriate or

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advisable in connection with any and all aspects of the Potential Amendment." B198, B199. Interpreting the resolutions as somehow stripping the committee of any power to condition approval on a stockholder vote would be contrary to this express authority to negotiate "terms and conditions" and to take other actions the committee determined to be appropriate.

Second, plaintiff argues that the board could have included language in the resolutions expressly stating that the special committee's approval power was subject to stockholder approval. Pl. Br. at 29-30. Directors do not expose themselves to non-exculpated claims of bad faith based on drafting choices in their resolutions. In any event, the case that plaintiff cites only further demonstrates why its reading of the resolutions is erroneous. Pl. Br. at 31 n.5. *In re WeWork Litigation* involved a special committee that did not have "final approval" authority: it was formed by resolutions stating that a "determination or recommendation by the Special Committee" would be "*subject to approval by the Board* and, if required by law or regulation, by the Company's stockholders." 250 A.3d 976, 998-99 (Del. Ch. 2020) (emphasis added). Here, by contrast, the members of the full board left nothing to come back to them, and any decisions about how to "exercise all the powers and authority of the Board"—including determining what other approvals may be needed—were delegated to the special committee. B198. In this context, the resolutions' reference

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to "final approval" makes sense as the final approval of the board, in contrast to a more limited committee recommendation role as in *WeWork*.

Finally, plaintiff argues that the Court of Chancery erred by interpreting the resolutions at the pleading stage. Pl. Br. at 29. But the "proper construction" of unambiguous text is "purely a question of law" that the court can decide on a motion to dismiss. *Exelon Generation Acquisitions., LLC* v. *Deere & Co.*, 176 A.3d 1262, 1266-67 (Del. 2017) (quoting *Rhone-Poulenc Basic Chems. Co.* v. *Am. Motorists Ins. Co.*, 616 A.2d 1192, 1195 (Del. 1992)); *e.g.*, *id.* at 1273 (interpreting unambiguous contract language); *Alta Berkeley VI C.V.* v. *Omneon, Inc.*, 41 A.3d 381, 386 (Del. 2012) (interpreting "unambiguous charter language"); *WeWork*, 250 A.3d at 999-1000 (applying principles of contract interpretation to resolutions on motion to dismiss); *Gassis* v. *Corkery*, 2014 WL 2200319, at *12 (Del. Ch. May 28, 2014) (same). Plaintiff identifies no ambiguity that precluded the Court of Chancery from ruling on the pleadings. This is even more true in light of plaintiff's own allegations—discussed further below—that the full board "did not consider whether the plans required stockholder approval for the modification," "[n]or did they determine that stockholder approval was not required." A103, ¶ 160. Plaintiff cannot defeat a motion to dismiss by offering an unreasonable interpretation of the resolutions that is contrary to its own allegations.

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The board, including the seven non-special committee directors, made no decision about whether the EMA Amendment should be approved or whether any decision by the committee to approve it would require further stockholder review. These directors cannot face a substantial likelihood of non-exculpated liability for a decision they did not make.

3. In any event, plaintiff pleads no plain and unambiguous breach of the equity plans.

Even if the seven non-special committee directors had made a decision about stockholder approval, that decision would be relevant to the demand-futility analysis under *Zuckerberg* only if it was an act of bad faith that exposes the directors to non-exculpated liability. Plaintiff invokes several Court of Chancery cases holding that the breach of an equity plan can rise to the level of bad faith in limited circumstances. *E.g.*, Pl. Br. at 32. But these cases make clear why even the decision that plaintiff imagines the board made—*i.e.*, precluding the special committee from putting the EMA Amendment to a stockholder vote—could not support a claim of bad faith here.

Demand is not "excused whenever a plaintiff alleges that a board violated the terms of a stock plan." *Pfeiffer* v. *Leedle*, 2013 WL 5988416, at *6 (Del. Ch. Nov. 8, 2013); *see also In re Ebix, Inc. S'holder Litig.*, 2014 WL 3696655, at *21 (Del. Ch. July 24, 2014) ("Informed decisions made in good faith by independent and

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disinterested directors, including decisions interpreting or implementing a stock option plan, are almost always beyond judicial second-guessing[.]"). Thus, as plaintiff acknowledges, Court of Chancery decisions have held bad faith pleaded only as to directors who approve a "plain and unambiguous" violation of a plan—a breach so clear that the directors' *knowledge* of the breach can be inferred. *E.g.*, Pl. Br. at 1, 5; *Pfeiffer*, 2013 WL 5988416, at *5 (plaintiff must plead "clear and unambiguous violation of the company's stock incentive plan"); *Garfield on behalf of ODP Corp.* v. *Allen*, 277 A.3d 296, 322 (Del. Ch. 2022) (plaintiff must plead breach of "plain and unambiguous provision"); *see generally McElrath*, 224 A.3d at 991-92 (bad faith requires allegation that "the director *knew*" he was breaching duties).

In a three-sentence section of its brief without any citation, plaintiff makes the conclusory assertion that the LTIPs unambiguously required stockholder approval for the EMA Amendment. Pl. Br. at 40-41. Plaintiff suggests that this was an allegation that should be "accepted as true" on a motion to dismiss. *Id.* at 40. But the requirements of the LTIPs are not issues of fact that can or should be accepted on a motion to dismiss. Contractual interpretation is a question of law, and plaintiff's conclusory interpretation is wrong.

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Under the LTIPs, stockholder approval is not required for adjustments to awards "in the event of" a spinoff or other corporate transaction. Section 3(e)(ii) of the UTC 2018 LTIP provides as follows:

> *In the event of* a stock dividend, stock split, reverse stock split, reorganization, share combination, or recapitalization or similar event affecting the capital structure of the Corporation, or a Disaffiliation, *separation or spinoff*, in each case without consideration, or other extraordinary dividend of cash or other property to the Corporation's shareholders, *the Committee or the Board shall make such substitutions or adjustments as it deems appropriate and equitable to*: (A) the aggregate number and kind of Shares or other securities reserved for issuance and delivery under this Plan; (B) the various maximum limitations set forth in Section 3(c) applicable to the grants to individuals of certain types of Awards; (C) the number and kind of Shares or other securities subject to outstanding Awards; (D) financial goals or measured results to preserve the validity of the original goals set by the Committee; and (E) *the exercise price of outstanding Awards*.

B004 at § 3(e)(ii) (emphasis added). Section 10(b) of the UTC LTIP similarly provides that, "[i]n the event of" a spinoff of other corporate transaction, "the Committee or the Board may in its discretion make such substitutions or adjustments as it deems appropriate and equitable," including to "the exercise price of outstanding Options and Stock Appreciation Rights." B017 at § 10(b).

The discretionary decisions of the board or a designated committee under these provisions do not require stockholder approval. Different provisions of the

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LTIPs that require stockholder approval for certain "repricings" of awards expressly exempt adjustments to exercise prices made under the provisions relating to spinoffs and other corporate transactions. Section 5(c) of the UTC 2018 LTIP thus restricts amendments to exercise prices "other than pursuant to Section 3(e)":

> In no event may any Stock Appreciation Right or Stock Option granted under this Plan be amended, *other than pursuant to Section 3(e)*, 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.

B005 at § 5(c) (emphasis added). The corresponding provision of the UTC LTIP similarly applies to amendments "other than pursuant to Section 10." B014 at § 5(c).

Plaintiff devotes much space to arguing that the EMA Amendment was a "separate modification" that was "not in connection with the spinoff." Pl. Br. at 31-34. The standard plaintiff purports to be applying is not rooted in the LTIPs, which provide the board or designated committee discretion to adjust awards, without stockholder approval, "[i]n the event of" a spinoff or other corporate transaction. B004 at § 3(e)(ii); B017 at § 10(b). There is no question that this

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"event" occurred—UTC spun off two subsidiaries—triggering the board's or its designated committee's discretionary authority to adjust awards.

For purposes of the Rule 23.1 motion at issue here, the ultimate merits of this contractual analysis is not at issue. The relevant question—again, assuming the counterfactual that the seven directors even made a challenged decision—would be whether the complaint pleads a violation of the LTIPs so plain and unambiguous that those directors *knew* that they were violating the plans and thus acted in bad faith. The text of the contracts allows no such conclusion.

The lack of a plain and unambiguous breach here stands in stark contrast to the cases on which plaintiff seeks to rely. *See, e.g.*, Pl. Br. at 32-34, 42-43, 46-48. Several of those cases involved allegations that directors approved more awards than permitted under a plan—a matter of objective math. *See Garfield*, 277 A.3d at 304, 306 (limit on "the number of performance shares that the Committee can award to any single individual in the same fiscal year" was "plain and unambiguous"); *Pfeiffer*, 2013 WL 5988416, at *2, *8 (award exceeded unambiguous annual per-recipient limit in stock incentive plan). Other cases involved "fraudulent documentation" about the date on which options were granted to circumvent an "express provision" requiring options to be priced "on the date the option is granted." *Ryan* v. *Gifford*, 918 A.2d 341, 345, 354-55 (Del. Ch.

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2007); *see also Conrad* v. *Blank*, 940 A.2d 28, 33, 40 (Del. Ch. 2007) (inferring compensation committee members knowingly violated requirement that "the exercise price of the options … be set at the full market price of the common stock at the close of trading on the date of grant").

Plaintiff incorrectly argues that *California Public Employees' Retirement System* v. *Coulter*, 2002 WL 31888343 (Del. Ch. Dec. 18, 2022), raised "the same issue" as this case, whether a "repricing" required stockholder approval. Pl. Br. at 33. Nothing in *Coulter* nor any of plaintiff's other cases involved the actual "issue" here: whether directors who delegated their authority could face liability for a plain and unambiguous violation of the plans. Even as to the directors who did make the decision (*i.e.*, the three directors on the special committee), however, *Coulter* is not an apt comparison. The court in *Coulter* found a clear violation of a provision requiring "shareholder approval of any amendment or revision that would 'change the minimum Exercise Price'" specified in the contract, since it was "undisputed that the repricings were conducted under the options plan without additional shareholder approval." 2002 WL 31888343, at *11. But unlike this case, *Coulter* did not involve a contract with a separate provision granting the

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board or committee discretion to amend exercise prices without stockholder approval in the event of spinoffs and other corporate transactions.[3]

Finding no support in the contracts, plaintiff invokes "accounting standards" that it says support its "separate modification" argument. Pl. Br. at 32. The pleading record nowhere suggests that plaintiff's accounting analysis is unambiguously correct.

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Plaintiff draws different conclusions from the alleged accounting standards, but such competing interpretations show that any alleged violation, if it existed, was not plain and unambiguous. *See Friedman* v. *Khosrowshahi*, 2014 WL 3519188, at *12 (Del. Ch. July 16, 2014), *aff'd*, 2015 WL 1001009 (Del. Mar. 6, 2015) (declining to infer a knowing violation where, "[a]t most, [plaintiff's] interpretation of the RSU Award raises a potential ambiguity that the Compensation Committee was entitled to interpret and resolve under the Plan"). As in *Friedman*, the LTIPs here gave the board or the designated committee authority to interpret the plans and resolve any ambiguity. *See* B003 at § 2(a)(x) (granting Committee "absolute authority … [t]o

[3] Plaintiff also cites *Coulter* and *Garfield* for the proposition that the business judgment rule does not apply when directors act outside the scope of their authority. Pl. Br. at 42-43. As shown above, however, none of the seven directors exceeded their authority when they delegated "the powers and authority of the Board," B199—not powers and authority that the board lacked.

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interpret the terms and provisions of this Plan and any Award issued under this Plan"); B013 at § 3(a) ("The Committee shall have full authority to administer the Plan, including the authority … to interpret the terms and provisions of the Plan ….").

Finally, plaintiff criticizes the information on which the board relied. *See, e.g.*, Pl. Br. at 39-40. These arguments, at most, relate to the board's exercise of due care. But "[i]t is not enough to allege that the directors should have been better informed," as any such claim is exculpated and cannot excuse demand. *See McElrath*, 224 A.3d at 993.

* * *

The seven independent, non-management directors who were not on the special committee delegated their authority as permitted by the LTIPs and Delaware law. They made neither the challenged decision to approve the EMA Amendment nor the decision whether to submit that amendment for stockholder approval. Accordingly, these seven directors face no possible liability for those decisions, let alone a substantial likelihood of non-exculpated liability. On this ground alone, this Court should affirm the Court of Chancery's grant of defendants' Rule 23.1 motion to dismiss.

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II. DEMAND IS NOT EXCUSED FOR THE INDEPENDENT REASON THAT PLAINTIFF'S PLEADING DEFEATS ANY INFERENCE OF A KNOWING BREACH.

A. Question Presented

Did the Court of Chancery correctly hold that demand is not excused for the independent reason that plaintiff alleges that a majority of the Demand Board made no knowing decision about stockholder approval?

B. Scope of Review

The dismissal of a complaint for failure to satisfy the particularized pleading standard of Court of Chancery Rule 23.1 is reviewed *de novo* by this Court. *Brehm*, 746 A.2d at 253-54.

C. Merits of Argument

The Court of Chancery held that, although the board made no decision about whether stockholder approval was required, "[e]ven if the Board [had] made the decision to forego stockholder approval, Plaintiff's pleadings fatally undercut the position that the Board did so in knowing violation of the LTIPs." Op. at 20. That holding was correct. As discussed above, pleading demand futility on the ground that a director faces a "substantial likelihood of liability" requires allegations of intentional misconduct—that the director "acted inconsistent with his fiduciary duties and, most importantly, that the director *knew* he was so acting." *McElrath*, 224 A.3d at 991-92. Plaintiff's own pleading fatally undercuts any

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inference of the required knowledge, and a claim "may be dismissed if allegations in the complaint … effectively negate the claim as a matter of law." *Malpiede* v. *Townson*, 780 A.2d 1075, 1083 (Del. 2001); *see also Tigani* v. *C.I.P. Assocs., LLC*, 228 A.3d 409, 409 (Del. 2020) ("Nor did the [trial court] err in declining to accept allegations as true that were contradicted by [plaintiff's] own words and documents."); *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006) (affirming rejection of argument "contradicted by the Complaint").

1. Plaintiff pleads that a majority of the Demand Board made no knowing decision to violate the equity plans.

Plaintiff's complaint repeats, time and again, that the board (including the seven non-special committee directors) did *not* consider, let alone decide, whether stockholder approval would be required to amend the EMA. For example, plaintiff alleges:

- The board never "[redacted]" A034, ¶ 13.
- The board "[redacted]" A035, ¶ 14.

[redacted]

- [redacted] A076, ¶ 109.
- The board never "[redacted]" A092, ¶ 138.
- The board "did not consider whether the plans required stockholder approval for the modification. Nor did they determine that stockholder approval was not required." A103, ¶ 160.
- The board conducted "[redacted]" A103, ¶ 161.

On appeal, plaintiff cannot disavow these allegations and does not even try to do so. To the contrary, plaintiff repeats the same alleged facts. *See* Pl. Br. at 3 ("The meeting materials *reflect no consideration* by the Board of the stockholder approval requirements in the relevant equity plans." (emphasis added)); *id.* at 23 ("[redacted]"). The Court of Chancery properly refused to accept a legal argument inconsistent with plaintiff's own allegations of fact. Taking plaintiff at its word, the board—and thus the seven non-special committee directors—did not

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consider the issue of stockholder approval. They could not have *known* they were breaching their duties as to an issue they did not consider.

2. Plaintiff's attempts to establish a knowing breach in spite of its pleading fail.

Plaintiff tries to escape its own pleading by arguing that the Court should "infer" the board's knowledge of the LTIPs. Plaintiff contends, for example, that each of the seven non-special committee directors knew about the stockholder-approval requirement in the LTIPs because "the Board was responsible for administration of the LTIPs and for seeking stockholder approval when necessary." Pl. Br. at 48. Plaintiff also notes that certain of these directors had knowledge of the plans either because they served on the compensation committee or were on the board when it solicited stockholder approval for the UTC 2018 LTIP. *Id.* at 50-51.

The relevant question in assessing whether directors acted in bad faith, however, is not whether they knew the contents of the LTIPs. That would be like saying directors knew the law or knew what their fiduciary duties were. Bad faith requires more—that a director knew he was *violating* his duties. *McElrath*, 224 A.3d at 991-92. Plaintiff cites no caselaw holding otherwise. Thus, as plaintiff concedes elsewhere in its brief, "knowledge is inferred *from the violation* of a clear and unambiguous term." Pl. Br. at 49 (emphasis added); *see Pfeiffer*, 2013 WL 5988416, at *5 (plaintiff must plead "a clear and unambiguous violation of the

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company's stock incentive plan"). As shown above, plaintiff does not plead that any director knowingly committed a "clear and unambiguous violation" of the LTIPs in light of their provisions permitting the board to adjust awards without stockholder approval in the event of spinoffs and other corporate transactions.

Moreover, as plaintiff's own citations show, bad faith can only be inferred "as to the directors who approved" a violative transaction—not any director who might have knowledge of the plans. *Garfield*, 277 A.3d at 322 ("[W]hen 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*." (emphasis added)). Thus, even if plaintiff could somehow show that the special committee members committed the required knowing violation, that would not excuse demand on the seven directors who did not participate in that decision.

Finally, plaintiff falls back on policy arguments that the Court of Chancery's holding would allow a board to immunize itself from liability by "burying its head in the sand." Pl. Br. at 49. This argument misunderstands the point of delegation, which Delaware law not only permits, but also encourages in certain contexts. A board is allowed to determine "the matters in which it will be directly involved, and those it will delegate." *Rosenblatt*, 493 A.2d at 943. The same is true under

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the LTIPs, which provide for the plans' administration, "*if the Board elects*, by the Compensation Committee or *such other committee of the Board as the Board may from time to time designate*." B003 at § 2(a) (emphasis added); *see also* B011 at § 2(i). The LTIPs also allow the designated committee to further "delegate all or any part of its responsibilities and powers to any person or persons" to make "final, binding and conclusive" decisions. B003-04 at §§ 2(b)(i), 2(c); *see also* B013 at §§ 3(b), 3(c). Directors who choose to delegate their authority over a topic necessarily do not spend their time considering it—they can rely on their colleagues who have been entrusted with the responsibility to do so. And should those chosen directors breach their duties while performing the delegated responsibilities, stockholders can demand that the rest of the board consider appropriate action. Because plaintiff failed to make such a demand without excuse, the Court of Chancery correctly dismissed this case.

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CONCLUSION

For the foregoing reasons, plaintiff has failed to plead that demand is futile. This Court should affirm the Court of Chancery's dismissal with prejudice of plaintiff's suit under Rule 23.1.

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DLA PIPER LLP (US)

/s/ John L. Reed
John L. Reed (I.D. No. 3023)
Ronald N. Brown, III (I.D. No. 4831)
Peter H. Kyle (I.D. No. 5918)
1201 North Market Street, Ste. 2100
Wilmington, DE 19801
(302) 468-5700
(302) 394-2341 (Fax)
john.reed@us.dlapiper.com
ronald.brown@us.dlapiper.com
peter.kyle@us.dlapiper.com

Attorneys for Defendants 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, and Nominal Defendant RTX Corporation

OF COUNSEL:

William Savitt
Graham W. Meli
Sunny S. Jeon
WACHTELL, LIPTON,
ROSEN & KATZ
51 West 52nd Street
New York, New York 10019
(212) 403-1000

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CERTIFICATE OF SERVICE

I, John L. Reed, hereby certify that on this 22nd day of November, 2024, I caused true and correct copies of the foregoing [PUBLIC VERSION] **APPELLEES' ANSWERING BRIEF ON APPEAL** to be served upon the following counsel of record in the manner indicated:

VIA FILE & SERVE*XPRESS*

Blake A. Bennett
COOCH AND TAYLOR, P.A.
The Brandywine Building
1000 N. West Street, Suite 1500, P.O. Box 1680
Wilmington, DE 19899

/s/ John L. Reed
John L. Reed (I.D. No. 3023)