

In the
Supreme Court of Delaware

CLARE C. MARSHALL,
Appellant

v.

CHARLES H. SALIGMAN, PATRICK C. RICHMOND, YVONNE M. CRAIG,
MARTIN R. ROTHSCHILD, ELAINE A. LASATER,
WILLIAM M. LEWIS, GILBERT W. COULSON, RACHEL N. LIEBERMAN,
TIMOTHY M. STOCKDALE AND CARLOS B. HUELVA,
Appelles

- and -

SECURANCE INCORPORATED,
Nominal Appellee

No. 27, 2009

BRIEF FOR THE APPELLANT

Filed by F, Counsel for Appellant

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NATURE OF PROCEEDINGS

On January 6, 2008, the Honorable Chancellor Sylvia K. Siegel dismissed Appellant Clare C. Marshall's derivative action against the Directors and Officers of Securance Corporation pursuant to Court of Chancery Rules 23.1 and 12(b)(6) in Civil Action No. 3892-CS. This is an appeal of the Court of Chancery's opinion that futility was not adequately pled. Plaintiff respectfully requests that this Court find that futility has been adequately plead and remand the case to the Court of Chancery with specific guidance on the standards misinterpreted by the lower court.

SUMMARY OF THE ARGUMENT

1. The lower court erred when it concluded demand futility was not met because the complaint contained particularized facts of director and officer oversight liability.

2. The Securance Directors and Officers were aware or should have been aware of ongoing legal violations at the company due to the presence of obvious "red flags." The Appellant's complaint sufficiently described why these red flags were known to the Directors and the Officers, and how these red flags should have alerted the Directors and the Officers to the violations. The Board's failure to address these red flags proximately caused irreparable harm to the Corporation.

3. The lower court erred additionally when it held the Non-Director Officer Appellees to the Rales pleading standard. The Rales standard was created to mirror the protections directors are afforded under the business judgment rule in instances where no direct action is taken. Because business judgment protections do not apply to officers, it was improper for the Court of Chancery to apply the Rales test to these Officers.

STATEMENT OF THE FACTS

Plaintiff, Shareholder Clare Marshall, brought a derivative action on behalf of Securance, a Delaware Corporation headquartered in Frederick, MD, against the Corporation's Board of Directors (hereinafter "Directors") and three Non-Director Officers, (hereinafter "Officers"). The Director Defendants named in the complaint are Charles H. Saligman, Patrick C. Richmond, Yvonne M. Craig, Martin R. Rothschild, Elaine A. Lasater, William M. Lewis and Gilbert W. Coulson. The Officer Defendants are Rachel N. Lieberman, Timothy M. Stockdale and Carlos B. Huelva. The complaint charged these Directors and Officers with a failure to discharge their fiduciary duty of oversight, causing severe financial harm to the Corporation.

Securance, as a private health maintenance organization (hereinafter "HMO"), is statutorily required to pay out 80% of collected revenues. If 80% is not paid out in care, the remainder of that 80% must be returned to the states. As a result of ongoing violations committed by senior managers seeking to increase profits, Securance violated the required payout rule and incurred heavy penalties.

The Directors and Officers were fully aware or should have been fully aware of these ongoing violations because of the presence of "red flags," which signaled trouble.

The first of these red flags was the Boards' adoption of a profits-based incentive plan for senior executives in 2003. This plan encouraged the company's officers to inflate earnings and created a corporate climate where fraud was permitted to flourish. The effects

of this flawed plan were apparent as early as 2004, when Securance was investigated and fined by state regulators in Connecticut and Virginia for giving improper financial incentives to doctors for denying services to Medicaid recipients. This resulted in Securance entering into consent decrees stipulating that they would no longer engage in such practices. These consent decrees were a second red flag, indicating that the regulatory compliance systems Securance had in place were not effective, and that the compensation plan the board adopted was directly at odds with achieving strict regulatory compliance.

The third red flag was Securance's near profit doubling from 2004 to 2005. This dramatic performance turnaround in a pervasively regulated industry widely known for thin profit margins and sluggish growth, and achieved at a time when revenues of competing HMOs were lagging considerably, amounted to yet another apparent red flag, which the board failed to investigate.

QUESTIONS PRESENTED

- I. Whether the lower court erred when it concluded that the Appellant did not allege with particularity that the Securance Directors and Officers faced a substantial likelihood of oversight liability, where the complaint adequately pled red flags that should have alerted them of ongoing violations.

- II. Whether the lower court erred when it applied the Rales standard to the Officers, where that standard was specifically created to protect directors only.

STANDARD OF REVIEW

Review of a Court of Chancery decision dismissing a derivative suit under Court of Chancery Rule 23.1 is de novo and plenary. Brehm v. Eisner, 746 A.2d 244, 253 (Del. 2000). When this Court considers a ruling by the Court of Chancery's on futility, "all reasonable inferences from non-conclusory factual allegations must be drawn in the plaintiff's favor." Grobow v. Pero, 539 A.2d 180, 187 (Del. 1988). Inferences that are objectively rational must be drawn in the plaintiff's favor. Brehm, 746 A.2d at 253.

ARGUMENT

I. The lower court erred when it ruled that Appellant did not allege with particularity that the Securance Directors and Officers faced a substantial likelihood of oversight liability.

A. Demand was futile because the Board was neither disinterested nor independent.

Before a derivative suit can be filed by a shareholder, a demand on the board of directors must be made to give the board an opportunity to decide whether the suit has merit. Aronson v. Lewis, 473 A.2d 804, 814 (Del. 1984). However, in certain cases demand may be futile and thus excused. Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993); Aronson, 473 A.2d at 814. To establish futility a petitioner must show that the board is not disinterested and/or independent, and is therefore incapable of making an impartial decision regarding the issue of litigation. Rales, 634 A.2d at 932. The mere threat of personal liability for approving a questioned transaction is insufficient to challenge the independence and disinterestedness of a board; however, when there is a substantial likelihood of liability, demand is excused. Aronson, 473 A.2d at 815.

1. Demand was futile because the Securance Directors were subject to a substantial likelihood of liability on the merits.

Because oversight is encompassed in the duty of loyalty, and directors cannot be exculpated under their corporation's bylaws, directors can be held liable for a breach of oversight. Del. Code Ann. Tit. 8, § 102(b)(7) (2008); Stone v. Ritter, 911 A.2d 363, 367 (Del. 2006). Under Stone, once the protection of 102(b)(7) no longer exists,

the directors may be held monetarily liable for their breach of duty. Id. Therefore, a showing of substantial likelihood of liability constitutes a showing that directors are not independent or disinterested. Id.

The independence of the Securance Directors hinges on the likelihood that they will be found liable for their failure to act. Id. This likelihood is established by a showing of particularized facts. Rales, 634 A.2d at 933. Because the complaint adequately plead these facts, demand should have been found to be futile. Stone, 911 A.2d at 367.

B. The lower court erred in finding that Appellant did not plead particularized facts that established a substantial likelihood of director liability.

Directors are liable for breaching their fiduciary duty upon a showing that (1) the directors knew or should have known about legal violations occurring at the company; (2) that the directors failed to take good faith steps to prevent or remedy those violations, and (3) that such failure proximately caused damage to the corporation. In re Caremark Int'l Inc. 698 A.2d 959, 971 (Del. Ch. 1996). Additionally, to be monetarily liable to the corporation, there must be a showing of a lack of good faith on the part of the directors. Stone, 911 A.2d at 368.

Appellant has pled particularized facts demonstrating that each of these elements has been met, thus meeting the heightened 23.1 pleading standard.

1. The Board knew or should have known of the ongoing legal violations at Securance.

A shareholder plaintiff meets his heightened pleading burden in an oversight case when there is adequate proof of red flags, or when there has been sustained or systematic failure of the board to exercise oversight. Caremark, 698 A.2d at 971. Directors cannot ignore red flags when they are "numerous, serious, directly in front of the directors, and indicative of a corporate-wide problem." Regina F. Burch, Director Oversight and Monitoring: The Standard of Care and the Standard of Liability Post-Enron, 6 Wyo. L. Rev. 481, 498 (2006).

The dramatic turnaround of the Securance's bottom line in the highly regulated HMO business, the Director-implemented executive incentive plan, and the decision to issue consent decrees were all serious issues apparent to the Directors; all these flags pointed to a systemic, corporate-wide problem. See Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1277 (Del. 1994) (defining material information as information a reasonable shareholder would consider when voting); (Compl. ¶ 19). Having described these red flags with the requisite particularity, this Court must therefore draw all reasonable inferences in the Appellant's favor. In re Citigroup Inc., 2003 WL 21384599, at *2 (Del. Ch. Jun. 5, 2003); Guttman v. Haung, 823 A.2d 492, 499 (Del. Ch. 2003); Rattner v. Bidzos, 2003 WL 22284323, at *13 (Del. Ch. Sept. 30, 2003, revised Oct. 7, 2003).

a. The pleading contained non-conclusory, particularized facts that the Directors knew or had reason to know of ongoing violations.

When viewed as a whole, the only reasonable inference to be drawn from these prominent red flags, is that the improper conduct at Securance escalated over the years putting them on notice of the violations—thus meeting the first element of the Caremark test. Caremark, 698 A.2d at 971.

While this Court has never explicitly defined what constitutes a red flag, this Court should consider them “any overt signs that are material in making informed business decisions” - the standard used to determine whether a decision is protected by the business judgment rule. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). A government settlement concerning allegations of illegal business practices, dramatic year-over-year profit increases, and a high-level compensation plan are all issues that are material to making informed business decisions, and therefore qualify as red flags. Id.; (Compl. ¶ 19).

b. The manner in which the red flags became known to the Securance Directors put them on notice.

The complaint in McPadden v. Sidhu adequately alleged facts that demonstrated the Directors had access to material information regarding the sale of a subsidiary; in finding the Directors liable, the court noted that the Directors had knowledge available that would alert them to the problems. 2008 WL 4017052, at *8 (Del. Ch. Aug. 29, 2008). In McPadden, the board of directors was found to have oversight

liability. Id. Similar to the directors in McPadden, the Securance Directors had direct knowledge of various financial indicators that showed a dramatic change in company operations, yet they failed to investigate the reasons for this change. (Compl. ¶ 44.)

In ATR-Kim Eng Fin. Corp. v. Araneta, a Director was found to have illegally transferred assets from the Corporation, causing severe financial harm and the eventual demise of the Company. 2006 WL 3783520, at *1 (Del. Ch. Dec 21, 2006). The court held the other Directors liable for failure to monitor operations during a period of dramatic financial volatility. Id. Like in ATR-Kim, the Securance Directors oversaw the Corporation during a period of financial volatility, and either knew or should have known that such volatility was unnatural. (Compl. ¶ 44.)

In Guttman, the Plaintiff was unable to show the precise roles the Directors played in the Company, or how the information should have been brought to their attention. 823 A.2d at 503. Unlike in Guttman however, the complaint shows that the Securance Board had direct access to the financial information that would put them on notice of the violations occurring at the Company.

In Wood v. Baum, the complaint unsuccessfully alleged that the Board executed reports and authorized transactions concerning matters like charitable payments and sales of nonearning assets. Opening Brief of Plaintiff Below at 13, Wood v. Baum, No. 621 (Del. Jan. 14, 2008). These duties were materially different from the duties of the Securance Directors, because the flags at Securance were higher-level and less day-to-day. 953 A.2d 136, 139 (Del. 2008). Unlike in Wood,

where the red flags pled were of a day-to-day nature, Appellant has adequately described high-level red flags that alerted the Board of ongoing violations. Also, unlike the Board in Wood, which only had five of its members on the audit committee, the entire Securance Board oversaw the audit committee. (Compl. ¶ 17.)

In Rattner, the Court of Chancery did not excuse demand because there was no showing of board involvement in the company authorization process. 2003 WL 22284323, at *13. However, unlike the Rattner Board, the majority of the Securance Board was actively involved in the oversight of high-level matters such as regulatory compliance issues and compensation plans, and the Board was even composed of three Officers; Saligman, Richmond, and Craig, who would necessarily have more intimate details of the Securance red flags by virtue of their more hands-on roles in the Company.

Performance Plan - Performance based compensation requires strict director oversight. Litt v. Wycoff, 2003 WL 1794724, at *9 (Del. Ch. Mar. 28, 2003). The Court of Chancery has acknowledged that incentive-based compensation encourages unsafe and unsound business practices, and that a "board of directors should closely monitor compensation tied to operating results." Id. The Securance Board should have exercised greater oversight after personally devising and implementing its incentive-based plan. The Board was fully aware that HMO profits were capped by state regulatory law, therefore they were either aware or should have been aware of the possibility that this plan could encourage artificial profit-inflation by company managers seeking greater compensation. (Compl. ¶ 9, 18-19); see generally Linda

C. Thomsen, Hedge Funds: An Enforcement Perspective, 39 Rutgers L.J. 541, 557 (2008) (explaining, in the context of hedge funds, that incentive compensations plans create an incentive to artificially inflate figures).

2004 Consent Decrees - In 2004, Virginia and Connecticut investigated Securance for denying Medicaid services in order to boost profits. (Compl. ¶ 19.) In response, Securance entered into consent decrees with those states. Id. The issuing of a consent decree may be seen as a "clear contractual intent to foreclose any latter judicial consideration." Barber v. Int'l Bhd. of Boilermakers, 778 F.2d 750, 756-758 (11th Cir. 1985). Major corporate legal decisions always fall under the purview of the board of directors, thus Securance's Directors were involved or should have been involved in the decision to issue these decrees. Del. Code Ann. Tit. 8, § 141 (2008). The need for consent decrees demonstrated to the Board the propensity for senior managers to circumvent state law in order to inflate profits. It also demonstrated that Securance's compliance systems were inadequate and closer oversight of senior managers was required. (Compl. ¶ 20.)

The facts in this case are distinguishable from Graham v. Allis-Chalmers Mfg. Co., where this Court found that consent decrees did not constitute red flags because the Director Defendants were either employed in very subordinate capacities or had no connection with the company during the relevant periods, and therefore had no duty to "ferret out any wrongdoing." 188 A.2d 125, 129 (Del. 1963). The Securance Board, unlike the Board in Graham, was seated at all

relevant times, both at the time of the 2004 consent decrees and at the time Appellant's complaint was filed. (Compl. ¶ 19.)

Drastically Increased Profits - Securance's drastically increasing profits (near doubling over one year), and their soaring stock price constituted a third red flag, especially when viewed in conjunction with the pervasive regulatory environment and the modest earnings of other HMOs. (Compl. ¶ 13.) In Rattner, the court held that there was nothing inherent in the elevation of a single financial statistic that should serve to put a board on notice of potential wrongdoing. 2003 WL 22284323, at *13. Here however, there was much more than a single financial statistic - there was a complete company turnaround. (Compl. ¶ 9.)

2. The Securance Directors took no steps to prevent or remedy the violations.

In Stone, the Company made a number of changes to ensure compliance, such as the creation of a compliance officer, a separate compliance department, and a Suspicious Activity Oversight Committee to monitor and report to its Directors. 911 A.2d at 371. After the events of 2003 and 2004, the Securance Directors failed to take any steps to prevent future problems within the corporation. Unlike in Stone, after the Securance Board found problems with its information and compliance systems, the corporation did not get an outside audit of those systems to prevent future violations. Id. Securance even failed to make even rudimentary changes in its systems. (Compl. ¶ 44.) This constituted both a failure to monitor the internal controls in place and a failure to adequately upgrade or restructure those

controls once it became clear that they were inadequate. (Compl. ¶ 44.)

3. The Securance Directors' lack of oversight proximately caused damages to the corporation.

In certain instances the fourth element of the Caremark test may, instead of constituting an element for the plaintiff, be considered an affirmative defense, therefore resulting in a burden shift as to causation. 698 A.2d at 971; Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 371 (Del. 1994). In Cede, this court reiterated the notion that breach of fiduciary duty without proof of injury is sufficient to rebut the business judgment rule. Id. Although the business judgment rule does not directly apply to oversight claims because there is no affirmative action taken by director defendants in such cases, the holding of Cede should extend to cases of director oversight liability. To find differently would present a burden so high that no oversight liability claims would pass the demand stage of litigation because shareholders are not entitled to discovery until after a futility determination. Rales, 634 A.2d at 935.

4. The Securance Directors lacked good faith.

The Directors did not act in good faith; accordingly they are liable to the shareholders. Stone, 911 A.2d at 369; Caremark, 698 A.2d at 971. In In re Walt Disney Co., this Court held that the failure to act in good faith occurs "where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." 906 A.2d 27, 67 (Del. 2005). The Directors knew that it was their duty to ensure Securance's compliance with

strict regulatory laws, and they disregarded those duties by ignoring all the aforementioned red flags. The Securance Directors had a monitoring system in place, however they failed to adequately monitor, upgrade, or restructure those controls after the 2004 violations. (Compl. ¶ 44.) The Directors then further breached their fiduciary duty and demonstrated their lack of good faith by failing to examine the corporation's dramatic earnings performance and soaring stock price between 2005 and 2007. (Compl. ¶ 51.)

II. The lower court erred when it granted a 12(b)(6) dismissal of the Plaintiff's claim against the Securance Officers because it mistakenly applied the same pleading standard to both corporate directors and officers.

Should this Court find that demand on the Securance Board of Directors was not futile, a less stringent pleading standard than the Rales test should apply to the Officers named in Appellant's Complaint. Rales, 634 A.2d at 934; (Compl. ¶ 2.) The heightened pleading required by Rales is employed to uphold the business judgment rules' protection of directors in instances where directors have made no conscious decision to act. Rales, 634 A.2d at 934.

Company officers however, as a matter of important public policy, should be held to a stricter standard of oversight accountability because of their integral role in day-to-day operations and their high level of involvement in the particular operational details of their companies. Lyman P.Q. Johnson, Corporate Officers and the Business Judgment Rule, 60 Bus. Law. 439, 440 (2005). The business judgment rule simply was not intended to grant officers the same degree of protection as their director counterparts, whose influence in daily

company decision-making is naturally limited as a result of their delegation of management duties to company Officers. Id. at 448. Because the lower court examined the claims against the non-director officers in the context of the deferential Rales test rather than using a stricter pleading standard, its granting of the 12(b)(6) motion for failure to state a claim was improper. Fed R. Civ. P. 12(b)(6) (2008).

A. Neither Delaware statute, nor precedent supports granting director protections to non-directors of corporation.

The General Corporation Law of Delaware states that the management of the business and affairs of a Delaware corporation “shall be entrusted to its directors, who are the duly elected and authorized representatives of the stockholders of that corporation.” Del. Code Ann. Tit. 8, § 141(a) (2008); Aronson, 473 A.2d at 811. Delaware law further holds that under normal circumstances, neither the courts nor the stockholders of a corporation shall interfere with the managerial decisions of those directors. 8 Del. C. § 141(a). This deference to director discretion is the foundation upon which the principle of the business judgment rule rests. Aronson, 473 A.2d at 812. Nowhere does Delaware statute grant special protections in derivative cases to officers specifically, nor does it contemplate giving any level of deference to non-directors of a corporation who are accused of breaching their fiduciary duties. Del. Ch. R. 23.1(a) (2008); Del. Code Ann. Tit. 8, § 142 (2008).

Delaware case law provides little additional guidance on the subject of pleading standards for non-director officers in oversight

liability cases, with the only cases addressing the subject doing so in either indirect or contradictory fashion. See generally Kelly v. Bell, 266 A.2d 878 (Del. 1970); Kaplan v. Centex, 284 A.2d 119 (Del. Ch. 1971). This court has in the past, on one occasion, stated in broad dictum that the business judgment rule applies to officers, but has never actually directly applied the theory in practice. See Kelly v. Bell, 266 A.2d 878 (Del. 1970) (where this court stated that the business judgment rule applies to both directors and officers, but in which damages were only sought against directors). This decision then directly conflicts with a later U.S. District Court decision that applies Delaware state law and reaches the opposite conclusion, specifically stating that the business judgment rule does not apply to a corporation's officers. See Platt v. Richardson, 1989 WL 159584 (M. D. Pa. Jun. 6, 1989). As a result of the sparse and ambiguous case law, there has been no clear precedent set by the Delaware courts, nor the courts of any other jurisdiction for that matter, and the question of officer status under the business judgment rule remains largely unsettled.

B. The lower court erred when it concluded that business judgment protections in general should extend to non-directors.

In applying the identical pleading standard to the Securance Officers as it did its Directors, without the benefit of guidance from this Court, the lower court made two erroneous assumptions of law. The first of these assumptions was to make the general conclusion that the business judgment rule applies with equal weight to both directors and non-director officers alike. (Compl. ¶ 27.) This conclusion fails to

consider the policy motivations behind the business judgment rule; (1) to protect the board of directors and the corporations they represent from being held hostage by unreasonable shareholder demands through strike suits, and (2) to allow directors to exercise the independent business judgment for which they were elected, free from the burden of judicial encroachment. 60 Bus. Law. 439 at 455.

Because officers do not possess the power to bring legal action on behalf of a company based on their status as officers alone, there is no concern that a corporate officer would be forced to bring a derivative action on behalf of a company by an unreasonable shareholder demand. 8 Del.C. § 141(a) (2008). As Delaware law has established, this is the sole province of the board of directors. Id. And because in all public corporations the directors ultimately have the final say on all major business and policy decisions, the fear that a shareholder or court could impose its will on its corporate decision-making process is a fear that only directors need realistically be concerned with. Id. Paradoxically, by granting business judgment protection to the officers, the court not only threatens to undermine the purpose of the rule itself, but also upset the legislative intent behind §141 of the General Corporation Law of Delaware, which was to vest ultimate corporate decision-making authority with the board of directors. 8 Del.C. § 141(a). Were officers given the same deference under the rule as directors, it would, in effect, limit the ability of directors to make considered business judgments on whether to pursue breach of fiduciary duty claims against officers serving at their behest. 60 Bus. Law. 439 at

464. This would occur as a result of making any such claims against officers much less likely to succeed, while also potentially increasing the number of wrongful termination claims brought by officers. Id. This precise scenario occurred when a Washington court erroneously granted business judgment protection to a senior manager accused of breaching his fiduciary duty of care by negligently failing to follow proper accounting procedures. Para-Medical Leasing, Inc. v. Hangen, 739 P.2d 717, 722 (Wash. Ct. App. 1987). As a result, the Manager was immunized from liability when the Company's Director and sole shareholder brought a breach of fiduciary duty action against him. Id. The ultimate outcome of this holding was to shift business judgment ability away from a director and place it instead in the hands of a court; an outcome in direct conflict with the business judgment rule. 60 Bus. Law. 439 at 465.

C. The lower court further erred when it applied the Rales test to non-directors.

The lower court compounded its error by further assuming, absent guidance from this Court, that the test for oversight liability should be the same for non-director officers as it is for directors; namely that the 'particularized facts of substantial likelihood' test this Court established in Rales to address director oversight should also be used in assessing liability in officer oversight cases. (Compl. ¶ 28.) Because the business judgment rule should not have an application to officers, there should be no such stringent requirement when assessing officer liability in oversight cases. Corporate officers are, like all members of the senior management team, agents

of their company, and therefore they have all the rights and duties that flow from that agency relationship. 60 Bus. Law. 439 at 449. As a result, the standard of pleading for these officers should be no higher than that of any fiduciary accused of breaching his ordinary duty of reasonable care to his principle. Brehm, 746 A.2d at 254; 60 Bus. Law. 439 at 461.

The Securance Officers Rachel Lieberman, Timothy Stockdale and Carlos Huelva breached their duty of ordinary due care by committing gross negligence in their oversight duties, allowing widespread fraud to flourish under their direct supervision. (Compl. ¶ 2-14.) These Officers, by virtue of their day-to-day roles in company operations, either knew or should have known of the existence of the fraud being committed based on the red flags described in part 1 of this brief.

In addition, in their plea agreements, the senior Securance managers who were convicted of fraudulently overstating Securance's medical loss ratios stated that they acted with either the express or implied support of the Company's senior Officers. (Compl. ¶ 10.) While the plea agreements do not implicate the three Officers by name, all three of those Officers either directly supervised or worked closely with these senior managers at all times, creating a strong presumption that they were at worst expressly supportive of the fraud, and at best guilty of turning a blind eye in taking no steps to prevent it (Compl. ¶ 8-10.) A showing of either would be sufficient to constitute gross negligence under the ordinary standard of reasonable care of a company agent. (Compl. ¶ 26.) In its opinion, the lower court states that, "based on the facts alleged by the plaintiff, a colorable claim likely

exists against the non-directors of Securance.” (Compl. ¶ 26.) In doing so, the court appears to concede that if a lower pleading standard of ordinary care were applied to these Officers, that liability would likely be found. (Compl. ¶ 26.) What the court fails to consider however, is that by cloaking these Officer’s actions under the auspices of the business judgment rule by applying the Rales test, they are undermining the very fiduciary duties these officers owe to Securance. 60 Bus. Law. 439 at 449. By granting them the same privileges as directors, the court is at best severely weakening the concept of the ordinary duty of care owed by a fiduciary, and at worst eviscerating it entirely.

This would be an extremely dangerous precedent to set given that we are in a period of history where corporate scandal and executive fraud, both perceived and actual, are at all time highs. Such a ruling would only serve to further shake the public’s faith in the corporate system, and encourage further wrongdoing on behalf of corporate officers.

There is therefore no compelling reason to imbue officers with a greater degree of protection from judicial review than any other employee or company representative accused of wrongdoing. The Rales test specifically, and the business judgment rule generally, are designed to protect the independent business judgment of directors to make the critical, strategic, long-term decisions of a corporation, and they should not be extended beyond that purpose to excuse the wrongdoing of company employees.

The court’s findings therefore that the business judgment rule

should be applied with equal weight to both directors and non-directors in general, and that the Rales test should be applied to the Officers in this case, represent erroneous conclusions of law. As a result, the lower court's granting of the defendant's 12(b)(6) motion was improper.

CONCLUSION

For the foregoing reasons, Appellant respectfully requests that this Court reverse the Court of Chancery's 23.1 dismissal as to the Securance Directors and remand the case for trial on the merits. Additionally we request that on remand this Court instruct the lower court to apply a less deferential pleading standard to the non-director officers than the one established in Rales.

Respectfully Submitted,

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