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No. 21-0098

IN THE
SUPREME COURT OF IOWA

KENDALL J. MEADE,
INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED,
Appellee,

v.

PETER S. CHRISTIE, STEPHEN A. CRANE, JONATHAN R. FLETCHER AND GRETCHEN H. TEGELER,
Appellants.

ON APPEAL FROM THE IOWA DISTRICT COURT
IN AND FOR POLK COUNTY
HONORABLE LAWRENCE MCLELLAN, DISTRICT COURT JUDGE

FINAL BRIEF FOR APPELLEE

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STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

I. Whether the district court correctly found that a public shareholder has standing to bring a direct action when corporate directors breach their fiduciary duties by helping the corporation's majority shareholder force through a squeeze out merger that undercompensates them for their shares

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II. Whether the District Court correctly found the facts alleged in the Petition stated a viable claim that the Director Defendants breached their fiduciary duties.

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David S. Walker, *Updating the Iowa Business Corporation Act*,
Iowa State Bar Association Annual Meeting (2002)

ROUTING STATEMENT

Plaintiff does not oppose the Director Defendants' request that the Iowa Supreme Court retain this interlocutory appeal.

STATEMENT OF THE CASE

The District Court correctly found the Petition states a claim that the Director Defendants breached their fiduciary duties to the public shareholders of EMC Insurance Group, Inc. ("EMCI" or the "Company") by orchestrating an unfair and conflicted sales process by which the Company was sold to its controlling shareholder, Employers Mutual Casualty Company ("EMCC"). As a result, EMCI's public shareholders were stripped of their shares in the Company in exchange for grossly inadequate consideration (the "Merger").[1]

EMCC and Bruce G. Kelley ("Kelley"), the CEO of both EMCC and EMCI, unilaterally decided to take EMCI private, coercing EMCI's minority shareholders to approve the merger with EMCC under the threat that Kelley and EMCC would continue to suppress the value of EMCI by refusing to consider any strategic alternatives. The members of the purportedly independent Special Committee[2] (the "Director Defendants") abdicated their fiduciary duties by agreeing to the flawed merger process and knowingly endorsing the plainly inadequate merger consideration contemplated by the merger.

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[1] The Merger closed in September 2019.

[2] The Special Committee comprised Individual Defendants Stephen A. Crane, Peter S. Christie, Jonathan R. Fletcher, and Gretchen H. Tegeler.

Recognizing EMCC taking EMCI private would implicate obvious and systemic fairness concerns, EMCC and EMCI crafted illusory protections for EMCI's minority shareholders, including by making the Merger contingent on approval of a "majority of the minority" shareholder vote, and nominally (but not actually) empowering the Special Committee to consider alternatives to the Merger. These protections were a sham; the Director Defendants sat by while EMCC unilaterally rebuffed strategic restructuring and third-party interest, and publicly announced it would not consider any third-party proposals. Worse yet, the Director Defendants actively assisted EMCC by excising material information from EMCI's Definitive Proxy Statement (the "Proxy").[3]

Strategic restructuring was not a "pie-in-the-sky" idea; the Director Defendants' financial advisors found a proposed quota share reinsurance agreement (the "Alternative Proposal") would create considerable value for EMCI's shareholders, including EMCC. Nonetheless, realizing the Alternative Proposal would greatly increase the price EMCC would have to pay to squeeze out EMCI's public shareholders, EMCC rushed it over to the Iowa Insurance Divisions' Deputy Commissioner of Supervision (the "Deputy Commissioner") for an "informal

[3] The Proxy is available on United States Securities and Exchange Commission's ("SEC") website at https://www.sec.gov/Archives/edgar/data/0000356130/000104746919004645/a2239424zdefm14a.htm.

decision" that it "was not fair and reasonable to EMCC's policyholders" and "would not likely receive regulatory approval." The Director Defendants "did not participate in this meeting," and did not follow up with the Deputy Commissioner about its "informal decision." "Informal decision" in hand, EMCC forthrightly rejected the Alternative Proposal.

Although everyone involved knew EMCI's value turned on the Alternative Proposal, the Director Defendants still "did not participate" in the meeting with the Deputy Commissioner or push back on the "informal decision." The Proxy shows the Director Defendants knew EMCI's intrinsic value turned on the Alternative Proposal: EMCC's "senior executives" presented it to the Deputy Commissioner on March 8, 2019, EMCC informed EMCI that it was rejecting it on March 15, 2019, and the Director Defendants first countered EMCC's proposal on March 20, 2019.

Meade filed the Petition in this case, alleging the Director Defendants, Kelley, and EMCC breached their fiduciary duties to EMCI's shareholders by negotiating the unfair Merger and obtaining shareholder approval through the misleading Proxy. The District Court denied the Director Defendants' motion to dismiss but granted Kelley's, EMCC's, and EMCI's motions to dismiss.[4] The District Court correctly

[4] The District Court granted Kelley's motion to dismiss on the grounds that the Proxy stated that Kelley fully recused himself from the sales process, though it is unclear whether Kelley participated in meetings regarding the Alternative Proposal as a member of EMCC management.

found the claims were direct based on the "special duty or distinct injury" test the Iowa Supreme Court uses to determine if shareholders' claims are direct or derivative. *See, e.g., Rieff v. Evans*, 630 N.W.2d 278, 293-94 (Iowa 2001); *see also Cunningham v. Kartridg Pak Co.*, 332 N.W.2d 881, 883 (Iowa 1983). The District Court also acknowledged that the Iowa Court of Appeals has followed Delaware law, recognizing plaintiffs have direct claims when corporate directors breach their fiduciary duties by orchestrating an unfair merger. *Kelly v. Englehart Corp.*, 2001 Iowa App. LEXIS 500 at *30 (Iowa Ct. App. July 31, 2001) (citing *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1245 (Del. 1999)). The Director Defendants appeal the District Court's determination that these claims are direct.

The District Court also rejected the Director Defendants' argument that the Petition failed to state a claim on its merits because the Petition did not plead around

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The District Court granted EMCC's motion to dismiss on the grounds that any fiduciary duties that controlling shareholders in publicly traded Iowa corporations owe are owed to the corporation itself and not to shareholders directly action. (App. at 883-887).

The District Court granted EMCI's motion to dismiss on the grounds that EMCI acted through its directors and EMCI could not "aid and abet" a fiduciary breach by the Director Defendants. (App. at 887-889).

Plaintiff did not seek interlocutory appeal of the dismissal of Kelley, EMCC, or EMCI but preserves these issues for final appeal.

EMCI's Exculpation Defense or "Director Shield Defense."[5] First, the District Court found that the Exculpation Defense is an affirmative defense beyond the scope of the motion to dismiss. (App. at 867-868). The Director Defendants appeal this finding. (Def.'s Am. Br. at 64-65)

The District Court also correctly rejected the Exculpation Defense on its merits, finding the Petition "stated a claim that the Independent Directors may have engaged in an intentional infliction of harm on the shareholders." (App. at 872-873); *see* Iowa Code § 490.202(2)(d)(1)(b). The Director Defendants appeal the District Court's finding that the Petition states a claim that the Director Defendants engaged in an intentional infliction of harm on minority shareholders, arguing that: (i) the District Court should have applied a "plausibility" standard of analysis rather than

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[5] The Director Defendants refer to Iowa Code section 490.202(2)(d)(1) as the "Director Shield Statute." (Def.'s Am. Br. at 55-73) To maintain consistency with other authorities discussing analogous laws authorizing exculpatory provisions, Iowa Code section 490.202(2)(d)(1) is referred to herein as the Exculpation Statute. *See* Carl Samuel Bjerre, *Evaluating the New Director Exculpation Statutes*, 73 Cornell L. Rev. 786 (1988); *see also, e.g., Emerald Partners v. Berlin*, 726 A.2d 1215, 1220 (Del. 1999) (referring to 8 Del. C. section 102(b)(7) as "Delaware's director exculpation statute").

The substance of the Exculpation Defense is that EMCI's articles of incorporation exculpate its directors from liability for money damages, "except liability for [self-dealing or unlawful distributions, or for intentionally violating criminal law or inflicting harm on the corporation or its shareholders]." Iowa Code § 490.202.

the ordinary notice pleading standard, and (ii) the District Court applied the wrong definition of "intentional."[6]

The Director Defendants' proffered rule that a Petition must "affirmatively plead that the Director Shield did not apply" is entirely formalistic and cuts against the well-established standard that a plaintiff must only provide "fair notice" of the claim for relief. *E.g., Christensen v. Shelby County*, 287 N.W.2d 560, 563 (Iowa 1980). Thus, the District Court analyzed the Petition and correctly found it stated a claim that the Director Defendants' intentionally harmed EMCI's public

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[6] The Director Defendants did not argue for a new "plausibility" pleading standard to the District Court (App. at 47-48, 52).

Because the District Court did not have any chance to address it, it should be deemed waived. *E.g., Podraza v. City of Carter Lake*, 524 N.W.2d 198, 203 (Iowa 1994) ("It is not our function to hear arguments counsel chooses to raise for the first time in this forum.").

Similarly, the District Court also rejected the Director Defendants' argument for business judgment deference because the merger employed the framework that the Delaware Supreme Court discussed in *Kahn v. M&F Worldwide*, 88 A.3d 635 (Del. 2014) ("*MFW*"). The Iowa Association of Business Industry and the Iowa Business Council has filed an *amicus curiae* brief in this interlocutory appeal, arguing that Iowa courts should adopt the holding in *MFW*. The Director Defendants did not join the *MFW* issues for interlocutory appeal, likely because the District Court found it "reasonably conceivable" that "at least some of the *MFW* factors are lacking." (Order at 38)

As *amici* do not have standing to raise issues outside the parties' briefs, *MFW* is outside the scope of this interlocutory appeal and Plaintiff does not address it. *See Rieder v. Segal*, 959 N.W.2d 426 (Iowa 2021).

shareholders by consciously conducting the merger process in an unreasonable manner inconsistent with their fiduciary duties. (App. at 872).

The Director Defendants confuse the issues by mischaracterizing the allegations in the Petition and the District Court's analysis, arguing they are entitled to an Exculpation Defense because the Petition does not allege that they acted with "subjective bad faith." (Def.'s Am. Br. at 66-67)[7] The express commentary to the Model Business Corporation Act ("MBCA") confirms that conduct need not be "motivated by an actual intent to do harm" when a director specifically intends to perform an action even though the director has actual knowledge that it will cause the harm. The District Court correctly recognized that "[d]eliberate indifference and inaction *in the face of a duty to act*" constitutes "conduct that is clearly disloyal to" shareholders, and engaging in *clearly* disloyal conduct intentionally inflicts harm on shareholders. See, *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005).

The aspects of the Order that are on appeal should be affirmed.

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[7] The Director Defendants first argued their proffered interpretation that a director does not engage in an intentional infliction of harm on the shareholders unless fiduciary action is "motivated by an actual intent to do harm" on Reply to the District Court.

STATEMENT OF THE FACTS

A. The Parties

EMCI is a publicly traded insurance holding company, and EMCC owned approximately 54% of its stock. (App. at 841). As EMCI's controlling shareholder, EMCC could unilaterally control all matters submitted to EMCI's shareholders, including electing Board members and approving (or disapproving) corporate transactions. (App. at 841-842). Bruce Kelley was President, CEO, and a director of both EMCI and EMCC. (App. at 842). The Director Defendants were directors of EMCI and comprised the Special Committee that negotiated the Merger on behalf of EMCI's shareholders. (App. at 842-843). In the years before the Merger, the Director Defendants received $2.5 million dollars in fees. (App. at 876).

EMCC is the parent company of its subsidiary EMC Insurance Companies. (App. at 841). EMCI relies entirely on EMCC's employees, facilities, and information technology systems, and its operations are integrated with EMCC and the EMC Insurance Companies through a reinsurance pooling arrangement. (App. at 841-842).

B. EMCC's Initial Offer

During EMCI's temporary weakness in late 2018, EMCC unilaterally decided to take EMCI private. (App. at 843). Shortly thereafter, EMCC publicly announced a non-binding proposal to purchase all of EMCI's stock that EMCC did not already

own at $30 per share. (App. at 843). In response, EMCI's Board formed the Special Committee comprising the Director Defendants. (App. at 843). Because EMCC already controlled 54% of EMCI's shares, Kelley and EMCC controlled the Director Defendants' future on the EMCI Board. (App. at 841-842). The Special Committee retained outside legal counsel on December 11, 2018, and engaged Sandler O'Neill & Partners, L.P. ("Sandler") to act as its financial advisors on December 19, 2019. (App. at 843). On January 8, 2019, the Special Committee directed Sandler to perform due diligence on EMCI's business and prospects. (App. at 843).

C. The Director Defendants Help EMCC Squeeze Out the Public Shareholders

On January 24, 2019, EMCC notified the Director Defendants it previously received and unilaterally rejected an unsolicited third-party proposal for a joint venture with EMCI. (App. at 843-844). The next day, Gregory Shepard, an EMCI shareholder owning approximately 1.1 million shares of EMCI common stock, sent a letter to EMCI's Board, asking to be appointed to the Special Committee. (App. at 844).[8] EMCC responded on January 31, 2019, by publicly announcing it would not consider any third-party proposals, effectively eliminating any possibility that

[8] *See also* Ex. 7.4 to Form 13D filed with the Securities and Exchange Commission on Jan. 25, 2019. Available at: https://www.sec.gov/Archives/edgar/data/0000356130/000119312519017402/d697787dsc13d.htm.

the Special Committee could meaningfully negotiate on behalf of EMCI. (App. at 844).

With EMCC blocking third-party transactions, the Director Defendants asked Sandler to prepare a counterproposal terminating EMCI's existing pooling agreement with EMCC and replacing it with the Alternative Proposal. (App. at 844). On February 22, 2019, Sandler presented separate valuation analyses for EMCI based on its existing management projections and based on the Alternative Proposal, which showed the Alternative Proposal would create considerable value for EMCI's shareholders. (App. at 844-845).

On February 25, 2019, the Director Defendants agreed the Alternative Proposal would create value for EMCI's shareholders and resolved to present it to EMCC, and denied Shepard's request to the join the EMCI Board and Special Committee. (App. at 844-845). On March 1, 2019, Shepard wrote a letter to the Special Committee indicating EMCC's proposal significantly undervalued EMCI and he was "in contact with investor(s) with the ability to make a superior offer." (App. at 845).

On March 5, 2019, representatives from EMCI and EMCC discussed the Alternative Proposal, with Director Defendant Crane explaining the Alternative Proposal would preserve EMCC's culture, distribution relationships and mix of business, and also allow EMCI to remain a public company, creating higher visibility

for the EMC Insurance Companies and preserving access to public equity capital. (App. at 845).

On March 6 and 7, 2019, EMCC's board of directors and management reviewed the Alternative Proposal. (App. at 845)(citing Proxy at 31). The very next day, "senior executives of EMCC met with the Deputy Commissioner to discuss the Alternative Proposal and received an informal decision from the Deputy Commissioner stating that, in his view, the Alternative Proposal was not fair and reasonable to EMCC's policyholders and would not likely receive regulatory approval." (App. at 845). The Special Committee "did not participate" in this meeting. (App. at 845).

On March 13, 2019, EMCC rejected the Alternative Proposal and reiterated its $30 per share offer. (App. at 845)(citing Proxy at 32). On March 20, 2019, the Special Committee, realizing EMCC had neutered its bargaining power by unilaterally rejecting the Alternative Proposal and refusing third-party transactions, made its first counteroffer at $40 per share. (App. at 846). On March 25, 2019, Shepard sent another letter to the Special Committee, clarifying he believed "Kelley's attempt to shut down the strategic alternatives review is a selfish act aimed at keeping tight control of EMCC and the Company" and was "not in the policyholders' interests or in the interest of the Company's shareholders." (App. at

846). Shepard's letter presented financial analyses indicating the fair price for EMCI common stock was "far in excess of $50 per share." (App. at 846).

Nonetheless, EMCC and EMCI negotiated the Merger Agreement, settling on a $36 per share price, including a "no shop" provision prohibiting EMCI or the Special Committee from engaging third parties, and rejecting a provision requiring EMCC to vote its shares in favor of unsolicited third-party proposals contemplating a price at least 10% higher than what EMCC was paying. (App. at 474-75, 846). The parties executed the Merger Agreement on May 8, 2019, and EMCC issued a press release announcing the Merger on May 9, 2019. (App. at 474-75, 846).

D. The Minority Shareholders Are Not Fully Informed When They Vote on the Merger

EMCI filed its preliminary and definitive proxies with the SEC in substantially the same form on June 24, 2019, and August 8, 2019, respectively, and scheduled the shareholder vote for September 18, 2019. (App. at 846, 194, 427). The Director Defendants knew the Proxy statements concealed material information that EMCI's public shareholders needed to make an adequately informed vote on the Merger. (App. at 871-872). Nonetheless, they did not disclose this information. (App. at 871-872, 876-877). EMCI's shareholders, insufficiently informed and otherwise left with the choice of either voting in favor of the Merger or retaining stock that would continue to be undervalued because EMCI's controlling shareholder was systemically and deliberately depressing its value by refusing to

consider alternative structures or third-party acquisitions, voted to approve the Merger on September 18, 2019. (App. at 846, 871-872, 876-877). Given the Hobson's choice EMCI minority shareholders faced, they were for all practical purposes coerced to "support" the unfair Merger. (App. at 876).

In short, the Director Defendants sat idly by while EMCC steamrolled them, by: (i) publicly announcing its grossly inadequate initial offer, (ii) unilaterally rejecting third-party interest and publicly announcing its refusal to participate in a third-party transaction, (iii) unilaterally rejecting the Alternative Proposal, (iv) rejecting EMCI's initial $40 per share valuation; (v) aggressively pressuring and forcing the Merger through at the inadequate price, and (vi) working restrictive provisions into the Merger Agreement to avoid a topping bid. (App. at 7). The Director Defendants knew from the beginning that the process favored Kelley and EMCC at the public shareholders' expense and not only played along, but ***actively assisted EMCC*** in obtaining approval by rebuffing Shepard and disseminating the misleading and incomplete Proxy.

ARGUMENT

The District Court correctly found Plaintiff had standing to bring direct claims against the Director Defendants for knowingly, willfully, and intentionally breaching their fiduciary duties to EMCI's public shareholders by negotiating and endorsing a merger that they knew undervalued EMCI. As the District Court

explained, their failure to negotiate adequate consideration for EMCI's public minority shareholders did not in any way harm EMCI or its majority shareholder EMCC. (App. at 862).

The District Court also correctly found the Director Defendants were not entitled to dismissal based on an Exculpation Defense because (i) exculpation is an affirmative defense, and (ii) the Petition sufficiently pled that the Director Defendants "engaged in an intentional infliction of harm on the shareholders" by negotiating and endorsing the Merger in spite of their actual knowledge that it undervalued the public shareholders' stake in EMCI. (App. at 871-872).

Because the District Court correctly decided the issues raised in this interlocutory appeal, the case should be remanded to the District Court with instructions to proceed to discovery and trial.

I. The District Court correctly held that a shareholder may bring a direct action against a director who endorses a merger and disseminates a misleading proxy with actual knowledge that the merger undervalues the company.

Preservation of Error

Plaintiff agrees that Director Defendants have preserve error.

Standard of Review

The standard of review for a district court's ruling on a motion to dismiss for lack of standing is for errors of law. *Hawkeye Foodservice Distrib. v. Iowa Educators Corp.*, 812 N.W.2d 600, 604 (Iowa 2012). The Court accepts the facts

alleged in the petition as true and must allow the case to proceed unless "the petition shows no right of recovery under any state of facts." *Id.* (quoting *Southard v. Visa U.S.A., Inc.*, 734 N.W.2d 192, 194 (Iowa 2007)). "If the viability of the claim is at all debatable, courts should not sustain a motion to dismiss." *Southard*, 734 N.W.2d at 194 (quoting *Munzingo v. St. Luke's Hosp.*, 518 N.W.2d 776, 777 (Iowa 1994)).

A. A shareholder has standing to bring a direct action against a director who endorses a merger and authorizes the filing of a misleading proxy with actual knowledge that the merger undervalues the company.

The Petition asserts direct claims that the Director Defendants breached the fiduciary duties they owed to EMCI's public shareholders. (App. at 34-35). It is well-established that directors of an Iowa corporation "owe[] a fiduciary duty to the company *and its shareholders*." *See, e.g., Cookies Food Products, Inc. v. Lakes Warehouse Distributing, Inc.*, 430 N.W.2d 447, 451 (Iowa 1988). These duties, commonly referred to as the duty of care and the duty of loyalty, require corporate directors to exercise due and appropriate care in managing corporate affairs and to discharge their duties in good faith and the best interests of the corporation and its shareholders. (App. at 863-865); *see also Cookies*, 430 N.W.2d at 451.

The general rule in Iowa and throughout the country is that "as a matter of corporate law, shareholders have no claim for injuries to their corporations by third parties unless within the context of a derivative action." *Rieff*, 630 N.W.2d at 293. However, Iowa jurisprudence accords with the "well-recognized exception" that a

shareholder has standing to bring a direct claim if the shareholder alleges that the defendant "owed him a special duty *or* that he suffered an injury separate and distinct from that suffered by the other shareholders." *Id.* at 294; *see Cunningham*, 332 N.W.2d at 883; *Ezzone v. Riccardi*, 525 N.W.2d 388, 394-95 (Iowa 1994) (quoting 13A William M. Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations* § 5921, at 519 (rev. ed. 1954)).

1. Claims alleging that a corporate director negotiated a merger or obtained shareholder approval of a merger in bad faith are direct claims that fall within the long-recognized exception to the general rule.

Considering this well-recognized exception, the Iowa Court of Appeals has explained that lawsuits based on "mismanagement that depresses the value of stock are derivative" but "suits directly attacking the fairness or validity of a merger are direct." *Kelly*, 2001 Iowa App. LEXIS 500 at *30. The Delaware rule has been adopted by courts throughout the United States. *Parnes*, 722 A.2d at 1245 ("In order to state a direct claim with respect to a merger, a stockholder must challenge the validity of the merger itself, usually by charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price."); *see also Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).[9] The rule is

[9] *See, e.g., Lusk v. Life Time Fitness, Inc.*, 213 F. Supp. 3d 1119, 1134-35 (D. Minn. 2016); *Keller v. Estate of McRedmond*, 495 S.W.3d 852, 876-77 (Tenn. 2016); *Shenker v. Laureate Educ., Inc.*, 983 A.2d 408, 422 (Md. 2009); *Cohen v. Mirage Resorts, Inc.*, 62 P.3d 720, 732 (Nev. 2003); *Yudell v. Gilbert*, 99 A.D.3d

grounded in the same factors that this Court considered in *Rieff* and *Cunningham*. *Id.* at 1033, 1039 ("[t]he proper analysis has been and should remain that stated" in *Parnes*, with the outcome turning "*solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?"); *cf. Rieff*, 630 N.W.2d at 294-95.

Whether a special application of the special duty or distinct injury test discussed in *Rieff* or a separate test, the "*Parnes*" test that the Iowa Court of Appeals used in *Kelly* is applicable here. Mismanagement outside the merger context affects the corporation directly and shareholders only indirectly, but a merger that undercompensates shareholders for their own personal property (their shares) harms them directly. *See, e.g., Cohen*, 62 P.3d 720 at 732 ("The shareholder has lost unique personal property—his or her interest in a specific corporation."). In other words:

> it is clear that, here, the injury alleged, namely, a lesser value that shareholders received for their shares in the cash-out merger, is an injury suffered solely by the shareholders and not by Laureate as a corporate entity. Such an injury, if suffered, is a direct one, separate from any injury suffered by the corporation, thus allowing Petitioners

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108, 110 (N.Y. App. Div. 2012); *Moore v. Macquarie Infrastructure Real Assets*, 258 So.3d 750, 756 (La. App. 3 Cir. 2017); *Elloway v. Pate*, 238 S.W.3d 882, 900-01 (Tex. Ct. App. 2007); *Rael v. Page*, 222 P.3d 678, 683 (N.M. Ct. App. 2009); *Lightner v. Lightner*, 266 P.3d 539, 545 (Kan. Ct. App. 2011); *Rupp v. Thompson*, 2004 Minn. Dist. LEXIS 16, at *6-8 (Minn. Lyon Cnty. Dist. Ct. Mar. 16, 2004) (interpreting Colorado law).

> to proceed with their direct action against Board Respondents. A higher or lower price received by shareholders for their shares in the cash-out merger in no way implicated Laureate's interests and causes no harm to the corporation.

Shenker, 983 A.2d at 425.

2. The District Court properly applied the special injury or duty test and correctly found that the claims in this case were direct and not derivative.

The District Court understood the *Parnes* rule properly accounts for the fact that an unfair merger harms the shareholders without meaningfully affecting the corporation:

> This is a situation where Meade contends he and other similarly situated suffered an injury separate and distinct from that suffered by the majority shareholder, EMCC. There was no injury to the corporation due to the nature of the merger. EMCI went from being a public corporation with the majority of its shares owned by EMCC to a private corporation with EMCC owning all of the shares of the corporation.

(App. at 860-861). The District Court is correct. An acquired corporation's "status would change from existing as a corporation to no longer existing in the same capacity because of the merger, regardless of the price paid" so, when there is an inadequate price, the shareholders suffer but there is "no meaningful difference to the corporation." *Moore*, 258 So.3d at 757. The Delaware rule also accords with common-sense: a "claim that arose via the non-voluntary termination of the Plaintiff's stock ownership cannot, as a matter of logic or equity, adhere in the stock

so taken." *I.A.T.S.E. Local No. One Pension Fund v. GE*, 2016 Del. Ch. LEXIS 184 at *17 (Del. Ch. Dec. 6, 2016).

Thus, under analogous circumstances in *Rieff*, this Court found that a mutual company's policyholders had a direct cause of action against the directors of a mutual company for breaching their fiduciary duties by orchestrating a *de facto* demutualization that terminated the policyholders' interest in the mutual company without providing adequate disclosure or compensation:

> If a mutual company would like to demutualize, it must follow statutory steps to that end. *See* Iowa Code ch. 515G. Some of those steps include providing notice and a vote in this decision to its policyholders. *Id.* §§ 515G.4, .6. Additionally, the policyholders will then receive some form of payout from this approved conversion, *e.g.,* through stock offers or dividends. *Id.* § 515G.3. These steps are not discretionary, but required. With an affirmative responsibility to disclose its intentions and seek approval from policyholders, as well as compensate them upon conversion, this creates a special duty not ordinarily cognizable between a mutual corporation and its policyholders.
>
> We have recognized that when a special duty is present, the shareholders suffer a harm not suffered by the corporation itself and have an individual action against the corporation. When there exists a special duty to the shareholder, outside of duties to the corporation, breach of that duty individually harms the shareholder and suit may be brought in that capacity. To this end, plaintiffs argue the interference with contract was specifically directed at them, not the corporation. Because of this, they claim to possess their own action.
>
> We agree.

Rieff, 630 N.W.2d at 294.

The special duties for demutualization in *Rieff* are analogous to the statutory steps and requirements for a corporate merger. *Compare* Iowa Code § 515G.6 (demutualization) ("the plan of conversion shall be submitted to and shall not take effect until approved by two-thirds of the policyholders") *with* Iowa Code § 490.1104(2)(a) (merger) ("the board of directors must submit the plan to the shareholders for their approval" and "must also transmit to the shareholders a recommendation that the shareholders approve the plan").

As this Court has explained: "A fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." *Kurth v. Van Horn*, 380 N.W.2d 693, 695 (Iowa 1986) (citing Restatement (Second) Torts § 874 cmt. A, at 300 (1979)); *see also Weltzin v. Cobank, ACB*, 633 N.W.2d 290, 294 (Iowa 2001) (quoting *Kurth*). Thus, submitting a "recommendation" to minority shareholders implicates a special fiduciary duty "to disclose with entire candor all material facts concerning the merger, so that the minority shareholders would be able to make an informed decision[.]" *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000); *Casey v. Brennan*, 780 A.2d 553, 569 (N.J. Super. Ct. 2001) ("Since implied in the concept of fair dealing is the duty of candor, it follows that the directors do not properly discharge their obligations when the proxy statement is false, misleading, and inaccurate."); *see also Mitchellville Coop v. Indian Creek Corp.*, 469 N.W.2d 258, 263 (Iowa Ct.

App. 1991) ("As fiduciaries, the directors owe a duty to disclose information to those who have a right to know the facts.") (citing *Rowen v. Le Mars Mutual Insurance Co.*, 282 N.W.2d 639, 649 (Iowa 1979)). Indeed, the special fiduciary duty to disclose the demutualization plan and fairly compensate policyholders that this Court found attached in *Rieff* is analogous to the Director Defendants' special fiduciary duty to disclose the plan of merger and fairly compensate shareholders. *See* Iowa Code §§ 490.1104(2)(a), 515G.6. As in *Rieff*, EMCI's shareholders have standing to bring a direct action against the Director Defendants for breaching those fiduciary duties.

3. The United States Court of Appeals for the Eighth Circuit agreed with the District Court that this Action is direct and not derivative.

In fact, the United States Court of Appeals for the Eighth Circuit recently explained that claims based on the termination of shares pursuant to this very Merger would be analogous to the termination of ownership in *Rieff*. *Shepard v. Emplrs. Mut. Cas. Co.*, 998 F.3d 330, 337 (8th Cir. 2021). The Director Defendants themselves acknowledge that the decision in *Shepard* "weighed in on this issue, involving this very Transaction." (Def.'s Br. at 36) (citing *Shepard*).

The *Shepard* decision is instructive. In *Shepard*, the Eighth Circuit affirmed the federal district court's finding that the claims were derivative specifically because the plaintiff ***did not*** attack the merger itself. *Id.* at 335 (explaining the

plaintiff alleged the defendants "breached their fiduciary duties '***in the years leading up to the Squeeze-Out***.'"); *see also Shepard v. Emplrs. Mut. Cas. Co.*, 476 F. Supp. 3d 862, 876 (S.D. Iowa 2020) (finding that there was no special duty because "Shepard has represented that his claim ***is not related to the merger*** ... but to failure to enhance the value of EMCI ***in the years prior to the merger***.").

Although the Director Defendants inconspicuously relegate it to a single footnote, the Eighth Circuit provided extensive analysis ***agreeing*** with the District Court in this case, as follows:

> **[T]he *Meade* court repeatedly distinguished that case from Shepard's claim.** The court emphasized that unlike Shepard, "Meade is not asserting a claim that the defendants mismanaged EMCI causing the stock to be undervalued." *Id.* at 23. While the shareholders' allegations in *Meade* were based on the squeeze out and inadequate purchase price, Shepard "alleged mismanagement by the defendants *prior to* the going-private transaction, which resulted in depressing the value of EMCI's stock." *Id.* (emphasis added). "Shepard was seeking recovery for an injury to the corporation, that was shared indirectly by the shareholders, which did not meet the separate and distinct injury test." *Id.* **In *Meade*, in the merger context, the injury was not shared by EMCI.** *See Id.*

Shepard, 998 F.3d at 338 (emphasis in italics in original, bold added); (Def.'s Am. Br. at 37 n.11). The Eighth Circuit also correctly distinguished *Shepard* from *Reiff*, explaining Shepard's claims were based on mismanagement that depreciated the value of his shares in the company in the years leading up to the merger, whereas the plaintiffs in *Rieff* – as here – had their ownership in the company terminated outright. *Id.* at 337 ("Unlike the termination of shareholder rights in a

demutualization, a reduction in share price is not an injury that solely affects the shareholders without harming the corporation.").[10] In fact, the federal district court in *Shepard* drew the same line between the general fiduciary duties that are "ordinarily cognizable" and the special duties that attach when corporate fiduciaries negotiate a demutualization or merger. *Shepard*, 476 F. Supp. 3d at 874.

Simply put, the District Court, and the federal courts in *Shepard* all agreed that "in the merger context" EMCI's public shareholders suffered injuries that neither EMCI nor EMCC suffered. EMCC—with the Director Defendants' active assistance—used its power as a controlling shareholder to shortchange EMCI's minority shareholders for their own personal property by millions of dollars in the aggregate. Not only did these injuries not harm EMCC—they inured to its ***benefit***. *See* 12B Fletcher Cyclopedia of the Law of Corporations § 5924 ("The exception to

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[10] Ultimately, the claims in *Shepard* were like the claims in *Kelly* and *Cunningham*, which were correctly found derivative because they alleged injuries to the corporation that were realized ***before*** the corporate sale rather than through it. *Kelly*, 2001 Iowa LEXIS 500, at *30 (plaintiff alleged company was undervalued because of prior mismanagement and waste of corporate assets); *Cunningham*, 332 N.W.2d at 883 (plaintiff sold company at a loss because defendant leased a defective meat processing machine to company in which he was a majority shareholder); *Shepard*, 998 F.3d at 337-38.

Naturally, the "premerger injury" rule in *Kelly*, *Cunningham*, and *Shepard* does not apply "if the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive shareholders of the standing to bring a derivative action." *See Kramer v. Western Pacific Industries, Inc.*, 546 A.2d 348, 354 (Del. 1988).

the rule forbidding direct shareholder suits against management is most compelling where the alleged wrong unfairly affected the minority shareholders but did not work an injury either to the corporation or its majority shareholders.").[11]

As a practical matter, shortchanging the public shareholders also benefited EMCI because any assets retained by EMCC now benefit the combined company. *Shepard*, 998 F.3d at 338 ("In *Meade*, in the merger context, the injury was not shared by EMCI."); *see also Shenker*, 983 A.2d at 425 ("a higher or lower price received by shareholders for their shares in the cash-out merger in no way implicated Laureate's interests and causes no harm to the corporation"); *Moore* 258 So. 3d at 757 ("the loss occurred to Plaintiffs, but made no meaningful difference to the corporation."). As the inadequate merger consideration harmed the shareholders directly and a damages remedy would be paid to the shareholders and not to EMCI, the claims are direct rather than derivative. *Rieff*, 630 N.W.2d at 293-95; *Tooley*, 845 A.2d at 1033; *Cunningham*, 332 N.W.2d at 883; *Kelly*, 2001 Iowa App. LEXIS 500 at *30.

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[11] The Director Defendants argue EMCC disabled its potential conflicts by conditioning the merger *ab initio* on approval by adopting the *MFW* framework. (Def.'s Am. Br. at 22); *see MFW*, 88 A.3d 635. But, as the District Court explained, it is "at least reasonably conceivable" that the Merger did not actually implement the *MFW* framework or effectively disable EMCC's conflicts and power to steer the transaction. (App. at 876-877).

4. The Director Defendants' argument that these claims are derivative directly contradicts Iowa law and their own representations to shareholders.

The Director Defendants' primary argument that Meade's claims are derivative flows almost entirely from their bald assertion that they did not owe fiduciary duties to EMCI's shareholders because a single statutory provision, Iowa Code § 490.830, does not explicitly use the word "shareholders." The argument is entirely unavailing: "While the director is subject to few statutory constraints, the Iowa courts have repeatedly held that a director is a trustee or quasi-trustee who owes fiduciary duties to the corporation *and its shareholders*." Matthew G. Dore, *The Duties and Liabilities of an Iowa Corporate Director*, 50 Drake L. Rev. 207, 211 (2002).[12]

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[12] *See e.g., Des Moines Bank & Trust Co. v. George M. Bechtel & Co.*, 51 N.W.2d 174, 216 (Iowa 1952) ("*Bechtel*"); *Gord v. Iowana Farms Milk Co.*, 60 N.W.2d 820, 828 (Iowa 1953); *Schildberg Rock Products Co. v. Brooks*, 140 N.W.2d 132, 136 (Iowa 1966); *Rowen*,, 282 N.W.2d at 654 ; *Linge v. Ralston Purina Co.*, 293 N.W.2d 191, 193-94 (Iowa 1980); *Midwest Management Corp. v. Stephens*, 343 N.W.2d 76, 77-78 (Iowa 1984); *Cookies*, 430 N.W.2d at; *Rieff*, 630 N.W.2d at 291.

Indeed, it is especially uncontroversial that Iowa Code § 490.830 does not specifically use the word "shareholders" because the official comment to the MBCA provision on which Iowa Code § 490.830 specifically explains that, in the phrase "best interests of the corporation,": "[t]he term 'corporation' is a surrogate for the business enterprise *as well as a frame of reference encompassing the shareholder body*." Model Bus. Corp. Act § 8.30, Official Comment 1 (emphasis added).

i. The Director Defendants have held themselves out to the investing public as owing fiduciary duties to shareholders directly.

The Director Defendants' argument that they do not owe fiduciary duties to EMCI's shareholders is especially repugnant because they previously acknowledged these duties to the investing public. *See Rieff*, 630 N.W.2d at 291 ("Because the circumstances giving rise to a fiduciary duty are so diverse any such relationship must be evaluated on the facts and circumstances of each individual case.") (quoting *Kurth*, 380 N.W.2d at 696). Indeed, EMCI's public SEC filings – ***including the Proxy urging shareholders to approve this very merger*** – expressly acknowledge the conflicting fiduciary duties EMCC's and EMCI's representatives owe to EMCC's policyholders ***and EMCI's shareholders***:

> On October 23, 2018, [EMCC's] Finance Committee met to review the financial performance and value of the Company .... After such review, the Finance Committee believed that such potential strategic alternatives would be challenging to implement given the Company's and EMCC's structure ... ***and the different fiduciary duties to both EMCC's policyholders and to the public shareholders.***

Proxy at 21; *see also* Proxy at 67, 72, 74 (stating that simplifying these competing fiduciary duties was one of EMCC's reasons for the merger). EMCI's Annual Reports on Form 10-K likewise explained the relationship between EMCI and EMCC implicated "potential and actual conflicts of interest" because Kelley and certain other directors and officers of both EMCI and EMCC owed "a fiduciary duty to both ***the stockholders of the Company*** and to the policyholders of Employers

Mutual." *E.g.,* EMCI's Annual Report on Form 10-K filed for the Fiscal Year Ending December 31, 2018, at 42; EMCI's Annual Report on Form 10-K filed for the Fiscal Year Ending December 31, 2017, at 43.

EMCI undoubtedly intended the investing public to rely on its SEC filings. *E.g., Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 568 U.S. 455, 462 (2013). Thus, it is particularly galling that the Director Defendants now argue they do not owe any fiduciary duties to EMCI's public shareholders after convincing those same shareholders to invest in EMCI and approve the merger through their affirmative representations that they were duty-bound to act in the public shareholders' best interests. *See Rieff*, 630 N.W.2d at 291.

ii. The Director Defendants' wholesale reliance on the absence of the word "shareholders" from Iowa Code section 490.830 is misplaced.

The Director Defendants entire argument that their fiduciary duties are owed solely to the corporation is based on the statutory language in Iowa Code section 490.830(1):

> Each member of the board of directors, when discharging the duties of a director, shall act in conformity with all of the following:
>
> a. In good faith.
>
> b. In a manner the director reasonably believes to be in the best interests of the corporation.

Iowa Code § 490.830(1). The argument is flawed for many reasons. Again, in context, "[t]he term 'corporation' is a surrogate for the business enterprise *as well as a frame of reference encompassing the shareholder body*." Model Bus. Corp. Act § 8.30, Official Comment 1 (emphasis added). Moreover, aside from the fact that the argument ignores entirely the numerous decisions of this Court that expressly find corporate directors owe duties to the corporation *and its shareholders*, many statutory provisions in the Iowa Code specifically contemplate fiduciary duties and liability to shareholders directly. *See, e.g.,* Iowa Code §§ 490.202(2)(d)(1) (Exculpation Statute authorizing a "provision limiting the liability of a director to the corporation or its shareholders"), 490.861 (contemplating "a proceeding by a shareholder or by or in the right of the corporation), 490.1108A(2) (contemplating a "duty of the director to the shareholders").

Nonetheless, the Director Defendants' fixation on the lack of the word "shareholder" in Iowa Code section 490.830 is the crux of their argument. They argue the District Court's finding that "shareholders may assert a direct claim when they challenge a merger . . . has never been adopted in Iowa, and is 'peculiar to Delaware law,'" and that "courts in other jurisdictions with comparable statutory frameworks as that adopted in Iowa consistently find that fiduciary duty claims against directors challenging the merger price negotiated by those directors are derivative." (Def.'s Am. Br. at 42) (quoting *Jarackis v. Applied Signal Technology,*

Inc., 2012 WL 9764184, at *3) (Cal. Super. Mar. 15, 2012)). The Director Defendants rely almost entirely on a single case decided by the Supreme Judicial Court of Massachusetts, *Int'l B'hood of Elec. Workers Local No. 129 Ben. Fund v. Tucci*, 70 N.E.3d 918 (Mass. 2017).

But "most courts" do not follow *Tucci*, nor do they reach the same "startling conclusion" that shareholders cannot bring direct claims when directors breach their fiduciary duties by negotiating a corporate sale on unfair terms. *See* James D. Cox & Thomas L. Hazen, 3 *Treatise on the Law of Corporations* 15:3 (3d ed.) (Dec. 2020 Update). And notwithstanding anything the Director Defendants say to the contrary, the majority approach plainly has been adopted in Iowa courts at least twice: by both the District Court in this case, and by the Court of Appeals in *Kelly*, which expressly applied a test upon which "suits directly attacking the fairness or validity of a merger are direct." *Kelly*, 2001 Iowa App. LEXIS 500, at *30. While the Director Defendants argue that this analysis in *Kelly* was "dicta," it was clearly *the specific test that the Kelly court used* to find that the claims were derivative because they involved "premerger mismanagement and breach of fiduciary duty." *Id.* at *3; (Def.'s Am. Br. at 41 n.13). Moreover, the Eighth Circuit in *Shepard* agreed. *Shepard*, 998 F.3d 330, at 338 ("In *Meade*, in the merger context, the injury was not shared by EMCI."),

Recognizing the on-point analysis in *Kelly* and the Eighth Circuit's decision in *Shepard* eviscerate their argument, the Director Defendants baselessly attempt to dismiss the pertinent portions of those opinions as "dicta." (Def.'s Am. Br. at 37 n. 11, 41 n.13) But the test was not "dicta" in *Kelly* or *Shepard* simply because the facts dictated a different outcome. *See Cunningham*, 332 N.W.2d at 883-84 (prescribing the test and finding the plaintiff's claims derivative because they were based on a pre-sale contract breach).

Moreover, the Director Defendants' own authorities contradict their argument that this Court should only look at "statutory framework" and ignore common law conventions. Indeed, the Massachusetts Supreme Judicial Court in *Tucci* explained its departure from the Delaware rule because "decisions reflecting our ***common-law principles***" prior to *Tucci* held that "the general rule of Massachusetts corporate law is that a director of a Massachusetts corporation owes a fiduciary duty to the corporation itself, and not its shareholders[.]" *Tucci*, 70 N.E.3d at 925-26 (emphasis added). Not so in Iowa, where this Court has repeatedly recognized that corporate directors' fiduciary duties run to both the corporation and the shareholders. *E.g., Rieff*, 630 N.W.2d at 291; *Linge*, 293 N.W.2d at 194; *Bechtel*, 51 N.W.2d at 179-80, 215.[13]

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[13] The Director Defendants' other authorities are inapposite for the same reasons. Def.'s Br. at 43-44. While the Director Defendants argue the inquiry turns on the specific language of the state's statutory fiduciary duties provision, they do

not even address statutory language aside from briefly discussing the statutes in *Tucci*, where the court expressly relied on "common-law principles." 70 N.E.3d at 925-26; (Def.'s Am. Br. at 43-44)

Indeed, the Director Defendants rely on California caselaw without acknowledging California's fiduciary duty statute specifically *does* provide that corporate directors and officers owe fiduciary duties to shareholders directly, perhaps because it undercuts their argument that courts must look to the statutory language. *See* Cal. Corp. Code § 309 (requiring every director to "perform the duties of a director ... in the manner such director believes to be in the best interests of the corporation ***and its shareholders*** ....").

The Director Defendants also rely on *Somers v. Crane*, 295 S.W.3d 5, 12 (Tx. Ct. App. 2009). As in *Tucci*, *Somers* simply found that, under Texas law, "[a] director's fiduciary duty runs only to the corporation not to individual shareholders or even to a majority of the shareholders." *Id.* at 11 (collecting cases). This Court has repeatedly held that officers and directors of Iowa corporations owe their duties to "the company ***and*** its shareholders." *Cookies*, 430 N.W.2d at 451 (emphasis added). Moreover, *Somers* explained that "the Class concedes that there is no Texas authority recognizing" a "'special relationship' between directors and shareholders created in the context of a cash-out merger," *Somers*, 295 S.W.2d at 12. In fact, at least one Texas Court of Appeals had recognized such claims as direct and not derivative. *Elloway*, 238 S.W.3d at 900-01.

The Director Defendants also rely on *Kadel v. Dayton Superior Corp.*, 731 N.E.2d 1244, 1247 (Ohio Montg. Ct. C. Pleas May 19, 2000), and *Gusinsky v. Flanders Corp.*, 2013 NCBC LEXIS 43 at ¶¶ 20-34 (N.C. Super. Ct. Beaufort Cnty. Sept. 25, 2013). *Gusinsky* actually found the plaintiff had direct claims that the defendants breached their duties of disclosure. *Gusinsky*, 2013 NCBC LEXIS 43, ¶ 45. More importantly, *Kadel* and *Gusinsky* found the shareholders' alleged injury "is precisely the injury suffered by the corporation itself." *Gusinsky*, 2013 NCBC LEXIS 43, ¶ 32-33; *Kadel*, 731 N.E.2d at 1247. These cases are plainly inapposite; the District Court in this action expressly found the Petition *did not* allege an injury to EMCI itself. (App. at 861); *see also Shepard*, 998 F.3d at 338.

DCG&T ex rel. Battaglia v. Knight, 68 F. Supp. 3d 579, 585 (E.D. Va. 2014) and *Baxter v. Syntroleum Corp.*, No. CJ-2013-5807, Slip Op. at p.4 (Okla. Tulsa Cnty. Dist. Ct. Jan. 14, 2016), also provide no support. They were based on state law precluding shareholders from bringing direct claims even for injuries that were

Moreover, the statutory language in Iowa Code section 490.830 that requires directors to act "in the best interests of the corporation" is not only shorthand for the shareholder body, it is also identical to the language in the predecessor provision governing the duty of loyalty. *E.g., Cookies*, 430 N.W.2d at 451-52 (explaining that "officers and directors occupy fiduciary relation to the corporation ***and its stockholders***" under Iowa Code section 496A.34) (emphasis added); *see also, e.g., Central Iowa Power Coop. v. Consumers Energy*, 2007 Iowa App. LEXIS 988, at *7 (Iowa Ct. App. Sept. 19, 2007) (quoting Iowa Code section 490.830 and going on to explain that "[t]hese obligations represent a fiduciary duty to a company ***and its shareholders***.") (citing *Cookies*, 430 N.W.2d at 451). The Director Defendants' argument that they may avoid the fiduciary duties they owe under Iowa common law because a single statute does not include the specific word "shareholders" is meritless.

Indeed, failing to appreciate that public shareholders suffer direct harm when they are shortchanged in a merger not only leads to "grave outcomes," it is also just

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separate or distinct. *Compare DCG&T*, 68 F. Supp. 3d at 586 ("whether the corporation or the shareholder sustained the injury, a breach of fiduciary duty by a director can be redressed only through a derivative action."); *Watkins v. Hamm*, 419 P.3d 353, 356 (Okla. Ct. Civ. App. 2017) ("The only statutory action authorized is the stockholders' derivative action."), *with Rieff*, 630 N.W.2d at 294 ("when a special duty is present, the shareholders suffer a harm not suffered by the corporation itself and have an individual action against the corporation.").

plain incorrect. *See* A. Raz, *A Purpose-Based Theory of Corporate Law*, 65 Villa. L. Rev. 523, 560-61 (Oct. 2020). The Director Defendants quote *Tucci* for the premise that "undervaluing EMC to secure [its merger and sale], qualifies as a direct injury to the corporation," (Def.'s Am. Br. at 43), but neither the Director Defendants nor *Tucci* ever explains how the corporation is injured. *See id.* at 561 (discussing *Tucci*) ("The court says that 'undervaluing [the corporation] to secure the merger ... qualifies as a direct injury to the corporation' – but how, exactly? None of the corporation's assets changed hands; only shareholders' stake was affected.") (alterations in original); *Shenker*, 983 A.2d at 425.

The closest the Director Defendants come to showing harm to EMCI is describing the shareholder compensation process:

> Consistent with the obligations running to the buyer and seller under the contract, EMCC paid the cash portion of the merger consideration first to EMCI's transfer agent, who then disbursed that money to the shareholders; and any portion of the cash payment not distributed to shareholders reverted back to EMCI.

(Def.'s Am. Br. at 50)

In the first place, the Director Defendants waived any argument that EMCI was directly injured because the transaction was processed through EMCI's transfer agent by not arguing it to the District Court. *State v. Baldon*, 829 N.W.2d 785, 789 (Iowa 2013). But, perhaps more importantly, it is unclear how EMCC disbursing the inadequate merger consideration through EMCI's ***transfer agent*** "directly

injured *EMCI* in the first instance, and the shareholders secondarily[.]" (Def.'s Am. Br. at 50). The transfer agent is presumably a separate entity from EMCI, and it is acting in a purely ministerial role by effectively wiring funds ***from EMCC directly to the shareholders***.

The Director Defendants also argue the "folly of Meade's analysis" is that EMCC "would" also have borne this injury if "EMCC had bought back its own shares," so that "EMCC did not pursue such a nonsensical approach does not change the analysis here." (Def.'s Am. Br. at 51) The real "folly" is begging the question that the Court should assume this step standard or proper when the Director Defendants themselves acknowledge it would be an otherwise "nonsensical" step taken ***solely to deny the shareholders recourse***.[14]

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[14] The Director Defendants claim that Meade had recourse through "a statutory appraisal remedy if he believed the Transaction price was too low." (Def.'s Am. Br. at 41 n.12)

In the first place, acknowledging the potential overlap between the shareholders' remedy for fiduciary breach and their remedy through appraisal simply shows how absurd it is to find these claims derivative: in a derivative action, the corporation and the shareholders are on the same side but they are directly opposing parties in an appraisal proceeding.

Moreover, this Court has previously followed Delaware law to find appraisal actions provide a "narrow remedy" that does not encompass common law claims for fraud or breach of fiduciary duty. *Davis-Eisenhart Mktg. Co. v. Baysden*, 539 N.W.2d 140, 143 (Iowa 1995); *Sieg Co. v. Kelly*, 568 N.W.2d 794, 802 (Iowa 1997). Rather, when a majority shareholder engineers a merger that benefits itself at the minority shareholders' expense, the minority shareholders must file a separate action against

Ultimately, the Director Defendants do not explain why this Court should scrap the existing common law tests distinguishing direct claims from derivative ones, and instead adopt their bright-line rule that a shareholder "suing for loss of property through deception or fraud has lost standing to right the wrong that arguably caused the owner to relinquish ownership or possession of the property." *Kramer*, 546 A.2d at 354. It would be passing odd to do so solely because Iowa Code section 490.830, just like its predecessor statute, does not include the word "shareholders." *See Cookies*, 430 N.W.2d at 452 ("We are obliged, however, to interpret statutes in conformity with the common law wherever statutory language does not directly negate it.").

iii. The Director Defendants also misread the community interest factors provision in Iowa Code section 490.1108A.

The Director Defendants also rely on *Tucci* to support their argument that Iowa Code section 490.1108A does not create a special duty that corporate fiduciaries owe in the specific context of a merger. *Tucci* is inapposite and the

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the directors who actually engineered the merger so that "the shareholders may seek recovery for breach of fiduciary duty." *Davis-Eisenhart*, 539 N.W.2d at 143.

In any case, the Director Defendants waived any argument that appraisal is an adequate or exclusive substitute, likely because this Court has held that it is not. (Def.'s Am. Br. at 41 n.12) This Court's approach is undoubtedly correct. *See Andra v. Blount*, 772 A.2d 183, 194-95 (Del. Ch. Ct. 2000) (recognizing that appraisals are often "economically impractical").

Director Defendants misread Iowa Code section 490.1108A for three reasons: (i) the "constituency statute" analog in *Tucci* (Mass. G.L.c. 156D, § 8.30) is a ***general*** fiduciary duties statute rather than a statute that specifically applies in the context of proposed takeovers; (ii) the Iowa provision only allows directors to consider the effects on stakeholders "in addition to consideration of the effects of any action on shareholder"; and (iii) the Iowa provision expressly contemplates a "duty of the director to shareholders." *Compare* Mass. G.L.c. 156D, § 8.30 ("General Standards for Directors") *with* Iowa Code §§ 490.830 and 490.1108A. The Director Defendants' arguments elide these crucial differences.

The Massachusetts provision states:

> (a) A director shall discharge his duties as a director, including his duties as a member of a committee:
>
> (1) in good faith;
>
> (2) with the care that a person in a like position would reasonably believe appropriate under similar circumstances; and
>
> (3) in a manner the director reasonably believes to be in the best interests of the corporation. In determining what the director reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, the region and the nation, community and societal considerations, and the long-term and short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

Mass G.L.c. 156D, § 8.30 ("General Standards for Directors").

In contrast, Iowa's provision states:

> 1. A director, in determining what is in the best interest of the corporation ***when considering a tender offer or proposal of acquisition, merger, consolidation, or similar proposal***, may consider any or all of the following community interest factors, ***in addition to consideration of the effects of any action on shareholders***:
>
>   a. The effects of the action on the corporation's employees, suppliers, creditors, and customers.
>
>   b. The effects of the action on the communities in which the corporation operates.
>
>   c. The long-term as well as the short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.
>
> 2. If on the basis of the community interest factors described in subsection 1, the board of directors determines that a proposal or offer to acquire or merge the corporation is not in the best interests of the corporation, it may reject the proposal or offer. If the board of directors determines to reject any such proposal or offer, the board of directors has no obligation to facilitate, to remove any barriers to, or to refrain from impeding, the proposal or offer. Consideration of any or all of the community interest factors is not a violation of the business judgment rule or of any ***duty of the director to the shareholders***, or a group of shareholders, even if the director reasonably determines that a community interest factor or factors outweigh the financial or other benefits to the corporation or a shareholder or group of shareholders.

Iowa Code § 490.1108A (emphasis added).

Thus, while the Massachusetts statute elevates the community interest factors *alongside* shareholders *at all times*, the Iowa provision only permits directors to consider the community interest factors in the context of a proposed merger, and only ***in addition to*** the effects of that proposed merger on the shareholders. The final sentence in the second subprovision is particularly illustrative:

> Consideration of ... the community interest factors is not a violation of ... any duty of the director to the shareholders ... even if the director reasonably determines that a community interest factor or factors outweigh the financial or other benefits to the corporation or a shareholder or group of shareholders.

Iowa Code § 490.1108A.2. Not only does the subprovision directly contemplate a "duty of the director ***to the shareholders***," it also makes clear that any director who ***unreasonably*** elevates the community interest factors over the financial benefits to the corporation and its shareholders ***violates that duty***. Put another way, the law acknowledges that directors' fiduciary duties require them to obtain a fair price for the shareholders if they sell the corporation. Under the common law, this duty required directors to *strictly maximize* shareholder value, and did not allow them to consider how a merger may affect other potential stakeholders. *See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). Thus, while Iowa Code section 490.1108A clearly modifies these *Revlon* duties, it does not nullify them outright; it simply allows directors to ***reasonably*** consider other stakeholders without breaching them. *See Cookies*, 430 N.W.2d at 452 (courts must

harmonize statutes in conformity with common law when possible). The upshot is that a director who *unreasonably* uses pretextual community interest factors to endorse a merger that favors the majority shareholder at the minority's expense – as the Director Defendants did here – breaches those duties.

The Director Defendants argue allowing shareholders to bring direct claims in the merger context would trigger a parade of horribles, because the Director Defendants find "no principled reason" that "other corporate stakeholders (vendors, employees, etc.) whom the statute puts on an equal footing with shareholders" could not also bring direct claims based on Iowa Code section 490.1108A. (Def.'s Am. Br. at 47 n.19). "Principled" as the Director Defendants may be, re-reading the plain language in Iowa Code section 490.1108A should mollify their concern: the provision clearly only contemplates a "duty of the director to the shareholders," and the use of the word "may" makes consideration of stakeholders other than shareholders ***permissive*** rather than compulsory. Iowa Code § 490.1108A. This reading is also consistent with the well-established body of common law holding that directors' fiduciary duties run to shareholders; notably, the Director Defendants do not cite (and Plaintiff is not aware of) any cases holding directors' fiduciary duties run to stakeholders like vendors or employees. *See Cookies*, 430 N.W.2d at 452. Simply put, the Director Defendants' parade of horribles argument is meritless.

As this Court held in *Rieff* and the Eighth Circuit explained in *Shepard*,

shareholders have direct claims when corporate directors breach the special fiduciary duties they owe public shareholders in the context of merger negotiations.

II. The District Court Correctly Found the Director Defendants Were Not Entitled to Dismissal Based on an Exculpation Defense.

After finding the claims direct, the District Court also correctly rejected the Director Defendants' Exculpation Defense, as both a procedural matter because it was an affirmative defense that was beyond the scope of a motion to dismiss, and as a substantive matter because the Petition alleged facts that implicated liability based on the Director Defendants' non-exculpable conduct, *i.e.,* intentional infliction of harm on EMCI's public shareholders. The District Court was correct on both points, and this Court should affirm.

Preservation of Error

The Director Defendants argued the Exculpation Statute to the District Court and properly preserved the issue generally. However, the Director Defendants argue *the first time on appeal* this Court should adopt a new "plausibility" standard rather than the notice pleading standard that ordinarily applies. As the Director Defendants did not argue that the District Court should apply a different pleading standard to the District Court, they did not properly preserve that issue.

Standard of review

The standard of review for a district court's ruling on a motion to dismiss is for correction of errors at law, accepting as true all well-pleaded factual allegations,

and dismissing "only if the petition shows no right of recovery under any state of facts.'" *Benskin, Inc. v. West Bank,* 952 N.W.2d 292, 298 (Iowa 2020) (quoting *Rieff*, 630 N.W.2d at 284).

As noted above, the Director Defendants, having agreed the District Court should analyze the case under the same notice pleading standards that ordinarily apply, have chosen to shift gears and now argue that Iowa courts should create a new "plausibility" standard for "claims potentially protected by the Director Shield Statute." (Def.'s Am. Br. at 56-61) The Director Defendants did not preserve this issue with the District Court, nor did they present it to this Court in their Application for Interlocutory Appeal.

A. The District Court correctly rejected the Director Defendants' Exculpation Defense because exculpation is outside the scope of the Petition, and because the Petition alleges facts that support a finding the Director Defendants intentionally inflicted harm on EMCI's public shareholders by negotiating the merger and obtaining shareholder approval in bad faith.

The District Court correctly rejected the Director Defendants' Exculpation Defense, both as a procedural matter, because it was an affirmative defense that was beyond the scope of the Petition, and on its merits, because the Petition alleged that the Director Defendants intentionally inflicted harm on EMCI's public shareholders. (App. at 865-872).

B. The District Court correctly found the Director Defendants' Exculpation Defense was an affirmative defense.

The Director Defendants first appeal the District Court's finding that the Exculpation Defense is an affirmative defense beyond the scope of a motion to dismiss. (Def.'s Am. Br. at 64-66). The District Court was correct, and the Director Defendants are wrong. This Court has repeatedly instructed that "[a] motion to dismiss is not a proper vehicle for the submission of affirmative defenses." *Stearns v. Stearns*, 187 N.W.2d 733, 734 (Iowa 1971) (quoting *Harrison v. Allied Mut. Casualty Co.*, 113 N.W.2d 701, 702 (Iowa 1962)); *see In re AHST Cmty. Sch. Dist. Pub. Measure "B" Election*, 735 N.W.2d 605, 606 (Iowa 2007) (affirming district court that denied a motion to dismiss "on the ground that it was precluded from looking outside the pleadings in a motion to dismiss" but ultimately dismissed the case based on the same affirmative defense after trial). The rule that "courts need not anticipate or meet potential affirmative defenses" is consistent with the standards of notice pleading. *Benskin*, 952 N.W.2d at 302 n.3. The only exception to this general rule is that "dismissal on the pleadings is appropriate when the plaintiff's allegations show that there is an airtight defense [such that he] has pleaded himself out of court." *Id*.

Realizing affirmative defenses are outside the scope of a motion to dismiss, the Director Defendants argue Iowa Code section 490.831 makes the *absence* of an exculpation defense an *element* of the claim for liability rather than an affirmative

defense, and argue the Petition should be dismissed because the "burden of pleading and proving an issue are inseparable." (Def.'s Am. Br. at 65) (citing *In re Estate of Kneebs*, 70 N.W.2d 539, 542 (Iowa 1955)). The Director Defendants' clever wordplay aside, this Court has repeatedly rejected their baseless assertion that a petition may be dismissed for failure to state a claim because it does not allege "ultimate facts that support each element of the cause of action":

> A "petition need not allege ultimate facts that support each element of the cause of action[;]" however, a petition "must contain factual allegations that give the defendant 'fair notice' of the claim asserted so the defendant can adequately respond to the petition." The "fair notice" requirement is met if a petition informs the defendant of the incident giving rise to the claim and of the claim's general nature.

Hawkeye Foodservice Distrib., 812 N.W.2d at 609 (alterations in original) (quoting *U.S. Bank v. Barbour*, 770 N.W.2d 350, 353-54 (Iowa 2009)).

The Director Defendants tellingly rely on just one case for their assertion that a petition must allege every fact that must ultimately be proven. (Defs.' Am. Br. at 64-66) (citing *Kneebs*). Even more tellingly, *Kneebs* not only predates the pleading rules in effect today, it has nothing to do with motions to dismiss or pleading standards. It says the same party that pleads an issue also bears the burden of proving that issue *at trial*; it plainly ***does not*** support the converse proposition that the Director Defendants assert, which is that a party must prove every element of their case ***at the pleading stage***. *Kneebs*, 70 N.W.2d at 542. No one suggested the

Director Defendants would bear the burden of proving that their conduct may be exculpated at trial.

The District Court's finding conforms with state and federal courts throughout the country that agree exculpation defenses are outside the scope of a motion to dismiss because "the protection of an exculpatory charter provision appears to be in the nature of an affirmative defense." *In re Tower Air, Inc. v. Nach*, 416 F.3d 229, 242 (3d Cir. 2005); *In re Taser Int'l S'holder Derivative Litig.*, 2006 U.S. Dist. LEXIS 11554, at *58 (D. Ariz. Mar. 17, 2006) (refusing consider Exculpation Defense at motion to dismiss state); *Kurlander v. Kaplan*, 2019 U.S. Dist. LEXIS 141879, at *17 (M.D. Fla. Aug 1., 2019) (same); *Frederick v. Corcoran*, 2013 Md. Cir. Ct. LEXIS 5, at *49 (Cir. Ct. Md. Aug. 14, 2013) (same); *see also Marsalis v. Wilson*, 778 N.E.2d 612, 616 (Ohio 2002); *Winkler v. Price*, 2013 U.S. Dist. LEXIS 99806, at *13-15 (D. Neb. July 17, 2013).

To be sure, some courts do take judicial notice of a company's articles of incorporation to consider whether a complaint only alleges liability that would be subject to exculpation. But even those courts acknowledge dismissal is only proper if "the factual basis for the claim *solely* implicates a violation of the duty of care," which involves a factual analysis that is often impossible to make at the motion to dismiss stage. *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 U.S. Dist. LEXIS 10983, at *49 (Jan. 23, 2019) (emphasis in original); *Chen v. Howard-*

Anderson, 87 A.3d 648, 676 (Del. Ch. 2014); *see also In re FSI Int'l, Inc.*, 2013 Minn. Dist. LEXIS 1, at *11 (Minn. Dist. Ct. Apr. 16, 2013) (rejecting exculpation defense where complaint alleged bad faith); *City of Aventura Police Officers' Retirement Fund v. Arison*, 70 Misc. 3d 234, 255 (N.Y. Sup. Ct. 2020) (same); *see also DCG&T*, 68 F. Supp. 3d at 588 ("The exculpatory clause may eventually provide a defense, but not one to defeat the complaint at this stage in the case.").

Moreover, whether the "reasonable conceivability" standard that applies in Delaware or the "plausibility" standard that applies in federal courts, courts that consider exculpation defenses at the motion to dismiss stage generally only do so under more rigorous pleading standards than the liberal notice pleading standard that this Court has prescribed, under which "a motion to dismiss may be properly granted 'only when there exists no conceivable set of facts entitling the non-moving party to relief.'" *Young v. HealthPort Techs., Inc.*, 877 N.W.2d 124, 127 (Iowa 2016)). Indeed, the Third Circuit thoroughly explained in *Tower Air* that the heightened pleading standard Delaware courts apply was inconsistent with the *old* federal notice pleading standard (*i.e.,* before *Twombly* and *Iqbal*), which continues to be used in Iowa:

> Delaware courts interpret Chancery Rule 8 to require pleading facts with specificity. That is not the federal notice pleading standard ... Delaware courts consider Chancery Rule 8 specificity requirements as consonant with notice pleading, but such notice pleading bears scant resemblance to the federal species ... the District Court erred by assuming that Delaware's notice pleading cases are interchangeable

> with federal notice pleading cases. They are not. By requiring [the plaintiff] to allege specific facts, the District Court erroneously preempted discovery on certain claims by imposing a heightened pleading standard not required by Federal Rule of Civil Procedure 8.

416 F.3d at 236-37.[15]

Ultimately, the Director Defendants' proffered rule that a Petition must "affirmatively plead that the Director Shield did not apply" is entirely formalistic and inconsistent with the standard that a plaintiff only must provide "fair notice" of the claim for relief. *E.g., Christensen*, 287 N.W.2d at 563 ("The rule does not require that specific theories be pled in the plaintiff's petition.") There is no reason to adopt it.

C. The District Court correctly found the Petition states a claim that the Director Defendants' intentionally inflicted harm on EMCI's public shareholders.

Although the District Court correctly found that the Exculpation Defense beyond the scope of a motion to dismiss, the District Court nonetheless analyzed

[15] The intermediate standard is appropriate for cases in Delaware Chancery Court where the majority of cases are brought, and where limited discovery generally proceeds while motions to dismiss are pending. *See Hawkeye Foodservice Distrib.*, 812 N.W.2d at 608 (rejecting proposed *Twombly* standard for lack of evidence that Iowa courts faced the "systemic pressures" facing federal courts); *see also Lewis v. LFC Holding Corp.*, 1985 Del. Ch. LEXIS 443 at *3-4 (Del. Ct. Ch. Apr. 4, 1985) ("It seems that the only reason for pursuing this litigation in Delaware is that it is apparently more difficult in the Florida courts to obtain expedited discovery and an accelerated preliminary injunction hearing date than it is in this Court."); *see also, e.g., I/MX Info. Mgmt. Solutions v. Multiplan, Inc.*, 2014 Del. Ch. LEXIS 44 at *10 (Del. Ch. Ct. Mar. 27, 2014).

how it would affect the Petition for the sake of completeness and rejected it. (Order at 33-34); *see* Iowa Code § 490.202(2)(d)(1)(b). The District Court explained the Petition stated a claim that the Director Defendants intentionally harmed shareholders by consciously disregarding their fiduciary duties in failing to: (i) reject EMCC's offer and maintain EMCI as a standalone company, (ii) disclose all material information in the Proxy, including by failing to include the financial analysis regarding the Alternative Proposal, (iii) adequately question Sandler regarding the financial fairness of the merger, including why the fairness analysis presented in the final board book and proxy utilized a higher discount rate than the financial analyses provided to the Board during the pendency of negotiations, and (iv) disclose the extent of third-party interest in a potential acquisition or joint venture with EMCI. (App. at 871).

In that light, the District Court correctly found the Director Defendants intentionally harmed shareholders by knowingly engaging in "a conflicted and flawed sales process resulting in inadequate compensation to the minority shareholders" and "*intentionally* failed to act in the face of a known duty to act, demonstrating *conscious disregard* for their duties." (App. at 871)(emphasis in original) The Director Defendants appeal the District Court's finding that the Petition sufficiently alleges that the Director Defendants engaged in an intentional

infliction of harm on the shareholders on the grounds that the District Court misinterpreted the word "intentional."

The Director Defendants' entire argument that the District Court applied the "wrong standard" boils down to their own erroneous reading that they cannot be liable unless they acted with "subjective bad faith" and "*specific intent to harm the corporation or its shareholders*." (Def.'s Am. Br. at 66-67); (Def's Am. Br. at 69) (arguing that EMCI's articles of incorporation exculpate the Director Defendants from liability unless they ""had *actual knowledge* their conduct would cause harm and *a specific intent* to cause that harm.") The Director Defendants' interpretation is inconsistent with the well-established legal meaning of intent and plainly contradicted by the specific commentary to the MBCA:

> *Intentional Infliction of Harm*
>
> There may be situations in which a director intentionally causes harm to the corporation even though the director does not receive any improper benefit. The use of the word "intentional," rather than a less precise term such as "knowing," is meant to refer to the specific intent to perform, or fail to perform, the acts with actual knowledge that the director's action, or failure to act, will cause harm, rather than a general intent to perform the acts which cause the harm.

Model Bus. Corp. Act § 2.02 off. cmt. 3.E (2017).

The comment's plain language is entirely consistent with the usual legal meaning of "intent," which is that either "the actor desires to cause the consequences of his act ***or*** that he believes that the consequences are substantially certain to result

from it." *Nesler v. Fisher & Co.*, 452 N.W.2d 191, 197 (Iowa 1990) (discussing Rest. (Second) Torts); *see also State v. Taylor*, 689 N.W.2d 116, 132 (Iowa 2004). Thus, a director acts with intent to harm if the director intends the act with ***either*** a "desire" to cause harm ***or*** a substantial certainty, *i.e.,* actual knowledge, that harm will result.

Here, the Director Defendants continued to engage in a hopelessly flawed sales process even though they knew EMCC's "senior executives" undermined them by unilaterally rejecting third parties out of hand and meeting with the Deputy Commissioner to obtain "informal rejection" of the Alternative Proposal without their input. Clearly, the Director Defendants specifically intended to continue with the flawed sales process in spite of actual knowledge that such a flawed process would produce inadequate consideration and thus harm EMCI's public shareholders. Every step of the way, the Director Defendants continued to engage with EMCC even though they knew EMCC designed the process to undercompensate shareholders.

Perhaps recognizing such conduct satisfies the MBCA commentary, the Director Defendants fashion a third element out of whole cloth: requiring not only that a director (1) specifically intend the act, with (2) actual knowledge that the act will cause harm, but also (3) that they perform the act with "*a specific intent* ***to harm the corporation or its shareholders***." (Def.'s Am. Br. at 66) (italics in original, bold

added); *but see* Mod. Bus. Corp. Act, § 2.02 off. cmt. 3.E (2017) ("The use of the word "intentional," ... is meant to refer to the ***specific intent to perform*** ... the acts with actual knowledge that the director's action ... will cause harm, rather than a general intent to perform the acts which cause the harm.") (emphasis added).

The Director Defendants attempt to bake their added "specific intent to harm" element into a block-quote about "bad faith" conduct from the Delaware Supreme Court:

> [A]t least three different categories of fiduciary behavior are candidates for the "bad faith" pejorative label. The first category involves so-called "subjective bad faith," that is, fiduciary conduct motivated by an actual intent to do harm. ... [S]uch conduct constitutes classic, quintessential bad faith. ...
>
> The second category of conduct ... is, fiduciary action taken solely by reason of gross negligence and without any malevolent intent. …
>
> [T]he third category of fiduciary conduct [*i.e.,* an "intentional dereliction of duty, a conscious disregard for one's responsibilities"] falls in between the first two categories. ... The question is whether such misconduct is properly treated as a non-exculpable, nonindemnifiable violation of the fiduciary duty to act in good faith. In our view, it must be ...

(Def.'s Am. Br. 66-67) (quoting *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 240 (Del. 2008)).

The Director Defendants argue "intentional infliction of harm" must be more "malevolent" than "mere 'conscious disregard of duty,'" and therefore must fit into

the first *Lyondell* category, which contemplates "***conduct motivated by an actual intent to do harm***." (Def.'s Am. Br. at 66-67) (quoting *Lyondell*, 970 A.2d at 240)

The Director Defendants' interpretation clearly fails for at least three reasons. The most obvious reason is that the commentary specifically provides guidance on how to interpret "intentional infliction of harm" and plainly does not require any "conduct motivated by an actual intent to do harm" or spite shareholders. The second reason is that a director engaging in an "intentional dereliction of duty" has "actual knowledge" that their conscious disregard for their own responsibilities will harm the shareholders justifiably relying on their fiduciary relationship. And the third reason is that, even assuming the Director Defendants are correct that an "intentional infliction of harm" requires "a more malevolent level of conduct" than an "intentional dereliction of duty," the Delaware Supreme Court not only never suggested the three *Lyondell* categories exhaustively described potential bad faith conduct, it "expressly disavowed any attempt to provide a comprehensive or exclusive definition of 'bad faith.'" *Lyondell*, 970 A.2d at 240; *see Chen*, 87 A.3d at 683 (discussing *Lyondell*).

A federal court recently considered the definition of "intentional infliction of harm" based on a virtually identical provision in the Model Nonprofit Corporation Act ("MNCA") that included virtually identical commentary, concluding that "according to the Model Act's Official Comment, a director's conduct rises to the

level of intentional infliction of harm if the director (1) intends the conduct; (2) with the knowledge that the conduct will cause harm." *Bronner v. Duggan*, 317 F. Supp. 3d 284, 292 (D.D.C. 2018). Thus, "a director's conduct may rise to the level of an intent to harm the director's organization or its members where the conduct is in service of a purpose that is clearly harmful." *Id.*

The Director Defendants' own authorities agree. For example, the Nevada Supreme Court explained in *Chur* that the Nevada Exculpation Statute, N.R.S. § 78.138(7)(b)(2), "must protect more than just directors (if any) who did not know what their actions were; it should protect directors who knew what they did but not that it was wrong." *Chur v. The Eighth Judicial District Court*, 458 P.3d 336 (Nev. 2020). But *Chur* simply stands for the seemingly noncontroversial premise that a claim based "solely on ***gross negligence***" or "***reckless*** disregard of a legal duty" does not involve "intentional misconduct, fraud, or a knowing violation of law." *Id*. at 342 (emphasis added). In other words, the *scienter* standard in *Chur* is entirely consistent with the Delaware standard: exculpation is possible for "fiduciary action taken solely by reason of ***gross negligence***" but not for misconduct through "***intentional*** dereliction of duty" or "***conscious*** disregard for one's responsibilities." *Lyondell*, 970 A.2d at 240. In fact, *Chur* explained that it "agree[d] and adopt[ed] the Tenth Circuit's definition of 'intentional and 'knowing' as enunciated in *ZAGG*," which itself adopted the Delaware standard that the plaintiff must show the

defendants "***knew of and consciously disregarded*** the problem." *In re ZAGG Inc. Shareholder Derivative Action*, 826 F.3d 1222 (10th Cir. 2016). Neither *Chur* nor *Zagg* found a plaintiff needs to show the defendant actually "desired" to cause harm.

The Director Defendants also argue that a "purported 'failure' to maintain EMCI as a standalone company cannot establish an 'intentional infliction of harm" because "[i]f it did, directors of a corporation would be liable in virtually every merger transaction that was closed." (Def.'s Am. Br. at 71) Their proposed rule certainly cannot be true here; EMCC – as majority shareholder – could unequivocally vote down any third-party acquisition proposal and had already publicly refused to engage with any third party. Thus, the power to say no definitively and continue operating EMCI as a standalone company was ***the only way the Director Defendants could stand up to EMCC***. Especially as the Director Defendants concede EMCC "unilaterally" squeezed out public shareholders, the power "to say no definitively" was the only power they actually had. *See MFW*, 88 A.3d at 645; (App. at 875). Although that power turned on unlocking the intrinsic value tied up in the Alternative Proposal, the Director Defendants stood idly by as EMCC's "senior executives" obtained "informal rejection" from the Deputy Commissioner. (App. at 469-70).

The Director Defendants also pull a block-quote to argue they cannot be liable for disseminating an incomplete and misleading proxy statement. (Def.'s Am. Br.

at 71) But they ignore the last sentence in the pull-quote: "The revision to Iowa's Business Corporation Act should make clear that a judgment as to the amount of disclosure required would be an action taken for which the articles may eliminate or limit liability ***except in the narrow and explicit circumstances stated***." (Def.'s Am. Br. at 71-72) (emphasis added) (quoting David S. Walker, *Updating the Iowa Business Corporation Act*, Iowa State Bar Association Annual Meeting. P. 16 (2002)) As the District Court explained, the Petition satisfied those "narrow and explicit circumstances" because the Director Defendants intentionally disseminated the Proxy with actual knowledge that it concealed material information about: (1) the amount of value potentially created under the Alternative Proposal, (2) the reasoning and justifications for certain downward revisions between November 2018 and May 2019, (3) the alteration of the discount rate used in the discounted cash flow analysis, and (4) Shepard's allegations that the merger process was tainted by conflicts of interest and breaches of fiduciary duty. (App. at 877).[16]

Finally, the Director Defendants argue the other allegations "are at best allegations that could support a lack of care, not an intentional infliction of harm to

[16] Moreover, the very limited discovery that took place during the brief period between the District Court denying the Director Defendants' motion to dismiss and this Court accepting this interlocutory appeal, appears to indicate the Director Defendants altered Sandler's Precedent Transactions Analysis presented on pages 53-54 of the Proxy to mislead shareholders and make the Merger appear more favorable.

EMCI." (Def.'s Am. Br. at 72-73) A director who knowingly engages in a "conflicted and flawed sales process" that is designed to undervalue the company is clearly engaging in an "intentional infliction of harm." Iowa Code § 490.202.2.d(1)(b) plainly does not include an additional requirement that the director be "motivated by an actual intent to do harm." *See Lyondell*, 970 A.2d at 240.

CONCLUSION

The Director Defendants may be held to account if they cannot establish the good faith, honesty, and fairness required of them, and the District Court correctly found the Petition more than sufficient to defeat their motion to dismiss.

However, in the event the Court finds dismissal warranted, Plaintiff respectfully requests leave to amend to include additional allegations that have come to light since the case was filed. *See* Iowa R. Civ. P. 1.402(4); *Rife v. D.T. Corner, Inc.*, 641 N.W.2d 761, 767 (Iowa 2002).

REQUEST FOR ORAL ARGUMENT

Kendall Meade requests to be heard in oral argument.

COST CERTIFICATE

I hereby certify that the costs of printing the Appellant's brief was $23.25, and that that amount has been paid in full by me.

CERTIFICATE OF COMPLIANCE

This brief complies with the typeface requirements and the type-volume limitation of Iowa R. App. P. 6.903(1)(*d*) and 6.903(1)(*g*)(1) or (2) because:

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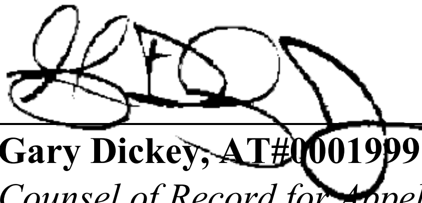

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