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Case No. 2017-0402-JRS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE FITBIT, INC. STOCKHOLDER DERIVATIVE LITIGATION	CONSOLIDATED C.A. No. 2017-0402-JRS

PLAINTIFFS' OPPOSITION TO NOMINAL DEFENDANT'S APPLICATION FOR CERTIFICATION OF INTERLOCUTORY APPEAL[1]

On December 14, 2018, the Court issued its Memorandum Opinion denying the Defendants' motion to dismiss (the "Order").[2] Nominal Defendant's Application for Certification of Interlocutory Appeal (the "Application") followed. The Application should be refused.

ARGUMENT

"No interlocutory appeal will be certified … unless the order of the trial court decides a substantial issue of material importance that merits appellate review before a final judgment."[3] "Interlocutory appeals ***should be exceptional, not routine***, because they disrupt the normal procession of litigation, cause delay, and can threaten to exhaust scarce party and judicial resources."[4] Considering an interlocutory application, "the trial court should identify whether and why the likely benefits of interlocutory review outweigh the probable costs, such that the

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[1] Capitalized terms assume the same meaning as the Court's Order (defined herein).

[2] *In re Fitbit, Inc. S'holder Deriv. Litig.*, 2018 WL 6587159 (Del. Ch. Dec. 14, 2018).

[3] Supr. Ct. R. 42(b)(i).

[4] Supr. Ct. R. 42(b)(ii) (emphasis added).

interlocutory review is in the interests of justice."[5] If uncertainty exists, interlocutory certification should be refused.[6]

In support of its Application Fitbit asserts that: (1) the Order conflicts with other trial court opinions on whether the "core operations" inference of scienter applies in considering an outside director's knowledge under Rule 23.1's heightened pleading standard; (2) the Order was incorrect by imputing Callaghan's and Murray's sales—through their affiliated funds—to them personally; (3) review of the Order may terminate the litigation; and (4) interlocutory review will serve the interests of justice. Each argument fails.

I. NO SUBSTANTIAL ISSUE OF MATERIAL IMPORT EXISTS.[7]

To obtain interlocutory certification an applicant must show that the trial court resolved a "substantial issue," which occurs only if the Court decided a substantive legal issue that relates to the ultimate merits of the action.[8] When a decision is "the result only of the application of well-established precedent to a set of particular and

[5] Supr. Ct. R. 42(b)(iii).

[6] *Id*.

[7] Even if a substantial issue of material import exists—and here it does not—the Court, exercising its "sound discretion," may refuse the Application. *U.S. Bank Nat'l Ass'n v. Wood*, 2018 WL 5787230, at *1 (Del. 2018).

[8] *Castalado v. Pittsburgh-Des Moines Steel Co.*, 301 A.2d 87, 87 (Del. 1973).

specific facts," it does not decide a "substantial issue."[9] As the Supreme Court explained in *Fuqua*, interlocutory review is inappropriate where "no final determination was being made on the merits of plaintiff's claims, but only that plaintiff would be afforded the right to pursue discovery related to the allegations of the complaint."[10]

Here, Fitbit, displeased with the Court's Order, seeks nothing more than a do-over. At bottom, Fitbit simply disagrees with the Court's application of the law to the detailed, particularized facts set forth in the SAC and the proper inferences drawn from those facts.[11] The Court's Order expressly recognized that it was not making a final determination, explaining: "To be clear, and this must be emphasized given the serious nature of these claims, I have found that Plaintiffs have *alleged* facts that are adequate to survive dismissal given the liberal pleading stage inferences to which they are entitled. Whether they can *prove* these facts very much remains to be seen."[12] Fitbit's arguments must be rejected.

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[9] *Ryan v. Gifford*, 2008 WL 43699, at *4-5 (Del. Ch. Jan. 2, 2008); *see also Capella Holdings, Inc. v. Anderson*, 2015 WL 4722710, at *1 (Del. Ch. Aug. 4, 2015).

[10] *Fuqua Indus., Inc. v. Lewis*, 504 A.2d 571 (Del. 1986) (TABLE).

[11] *See, e.g.*, Application at ¶13 ("[N]o well-pled facts in the Complaint support the inference that the Outside Directors 'knew of the alleged material, non-public information.'").

[12] *Fitbit*, 2018 WL 6587159, at *1 n.2.

A. The Order Is Consistent With Other Trial Court Opinions.

According to Fitbit, "Courts have repeatedly" refused to apply the "core operations inference in the context of Rule 23.1's heightened pleading standard."[13] Fitbit is wrong. In the cases relied on by Fitbit, the Court refused to infer scienter where the pleading—unlike the SAC—omitted any other particularized allegations to infer scienter.

For example, Fitbit's reliance on *Sandys* is misplaced.[14] In *Sandys*, the court did not adopt a *per se* rule that the "core operations" doctrine could never apply to infer a defendant's knowledge. Rather, the court merely concluded that because the complaint there lacked "particularized allegations," it was insufficient under Rule 23.1, standing alone, to infer scienter under the core operations doctrine.[15] The *Sandys* court also noted that "plaintiff's 'red flags' allegations against [defendants] boil down to [a conclusory] contention that they should have known trouble was afoot at the company merely because the Secondary Offering was proposed."[16]

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[13] Application at ¶16.

[14] *Sandys v. Pincus*, 2016 WL 769999, at *17 (Del. Ch. Feb. 29, 2016), *rev'd on other grounds*, 152 A.3d 124 (Del. 2016).

[15] *Id.*

[16] *Id.*

Moreover, unlike *Pfeiffer*,[17] and the facts alleged in the SAC, the court in *Sandys* also found that the complaint lacked any allegations that the outside directors sold substantial amounts of stock giving rise to a potential inference of scienter.[18]

Here, Plaintiffs did not argue—nor did the Court hold—that the Defendants' scienter (or knowledge) of material, nonpublic information was inferred solely based on the "core operations" doctrine.[19] Rather, the Court identified well pleaded facts which, considered in their totality, permitted a pleading-stage inference that Defendants acted with the requisite scienter, including:

- Numerous communications and presentations—one appearing to be a board document—were created and distributed detailing PurePulse™'s flaws and internal testing;[20]
- PurePulse™ "account[ed] for almost 80% of the Company's revenue" and "were the primary drivers of [Fitbit's] revenue growth";[21]

[17] *Pfeiffer v. Toll*, 989 A.2d 683 (Del. Ch. 2010), *abrogated on other grounds by Kahn v. Kolberg Kravis & Roberts & Co.*, 23 A.3d 831 (Del. 2011).

[18] *Id*.

[19] *See* Application at ¶13 (conceding that the Order did not rely "solely on the core operations inference …").

[20] *Fitbit*, 2018 WL 6587159, at *12. Considering the "paranoia" around PurePulse™'s accuracy and management's explicit instruction that the slides were "not [to] be distributed in any form" and were to be "destroy[ed]" once the presentation was over, it is not surprising that a discussion of these issues is omitted from formal board minutes. *Id.* at *7.

[21] *Id.*

- The nature, timing, and size of offerings;[22]
- The timing and selective waiver of the lock ups;[23] and
- The timing and size of the stock sales and the Board's decision to lower Fitbit's allocation in the Offerings ensuring the overallotment was triggered, causing more of the Defendants' shares to be sold in the Offerings.[24]

"Having considered the foregoing, [the Court was] satisfied that Plaintiffs have pled particularized facts that support a reasonable inference that … four of seven" Fitbit board members "possessed material, nonpublic information and relied on that information when making trades …."[25]

Fitbit's reliance on *Desimone* also does not further its cause.[26] In dismissing that action, the *Desimone* court noted that "the complaint itself [concedes] that much of [the] backdating operation was carried out by a single executive officer" and "was actively concealed from the board …."[27] The court in *Desimone*, therefore, concluded that the complaint failed to plead particularized facts "suggesting an

[22] *Id.*

[23] *Id.* at *16.

[24] *Id.*

[25] *Id. at* *17.

[26] *Desimone v. Barrows*, 924 A.2d 908, 914 (Del. Ch. 2007).

[27] *Id.* at 914.

inference that the directors who knew of the Officer Grants intended them to be a form of hidden bonus to be concealed from regulatory authorities."[28]

Contrary to Fitbit's assertions, the Court's Order does not conflict with the *Sandys* or *Desimone* decisions and those decisions do not adopt a *per se* rule that a court, in deciding a motion to dismiss pursuant to Rule 23.1, may not infer scienter, in part, based on the core operations doctrine.[29]

Finally, Fitbit takes issue with the Court's consideration of the judicial opinions in the related Securities Action as "a relevant factor in the *Rales* analysis."[30] Once again, Fitbit does not challenge the law which the Court applied; instead, Fitbit contends that the Court was wrong in how it applied the law to the facts as set forth in the SAC. The Court's application of the law here was correct. Of particular import

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[28] *Id*. at 916.

[29] Fitbit also cites *In re Forest Laboratories, Inc. Derivative Litigation*, 450 F. Supp. 2d 379 (S.D.N.Y. 2006), for the stale proposition that since the "[c]omplaint cannot allege that Fitbit's product issues had any impact on sales … no inference of knowledge can be drawn." Application at ¶18. Again, however, Fitbit's reliance on *Forest* is misplaced as the court there noted "[c]ursory allegations that a director made sales … in the market at a time when he possessed material, nonpublic information are not sufficient …." *Id.* at 389. The *Forest* court further noted that "[t]he complaint contains no particularized allegations that, if true, would establish that any of the [directors] were in possession of adverse nonpublic information …." *Id.* Unlike *Forest*, the SAC was developed utilizing Fitbit's own books and records and pleads with particularity significantly more detail than "cursory allegations" concerning the Defendants' stock sales.

[30] *See Fitbit,* 2018 WL 6587159, at *16.

to the Court's *Rales* analysis was the fact that each Defendant was a named defendant in the parallel Securities Action at the time this action was filed. Had the Company elected to proceed forward against the Defendants on a *Brophy* claim, it certainly would have undercut Defendants' defense in the Securities Action, irrespective of the particular claims alleged against each Defendant. Thus, as in *Pfeiffer*, Defendants were incapable of impartially considering a demand.[31]

B. The Court Correctly Applied The Law.

Fitbit's Application is also premised on the idea that because Plaintiffs have not *proven*—at the pleading stage—that Callaghan and Murray personally benefitted from the challenged stock sales in the Offerings they cannot face liability under *Brophy*.[32] Again, Fitbit's Application simply reflects its disagreement with the Court's application of well-settled law; it merely requests a "do-over."

Fitbit's Application ignores that the Supreme Court affirmed the court's articulation of the elements essential for a plaintiff to prevail on a *Brophy* claim in *Oracle*.[33] Contrary to Fitbit's assertion, nowhere in *Oracle* did the Supreme Court

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[31] *Fitbit*, 2018 WL 6587159, at *16, n.190.

[32] Application at ¶¶20-22.

[33] *See Kahn*, 23 A.3d at 838 (citing *In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904 (Del. Ch. 2004), *aff'd*, 872 A.2d 960 (Del. 2005)); *accord Guttman v. Huang*, 823 A.2d 492, 502 (Del. Ch. 2003) (emphasizing the focus on "trading activity").

require the fiduciary to personally benefit from the stock sales under *Brophy*.[34] Instead, the Supreme Court only required that plaintiff plead that the fiduciary "used that information improperly by making trades because she was motivated, in whole or in part, by the substance of that information."[35]

Fitbit's assertion that the Court's holdings are "unprecedented and mistaken as matter of Delaware law" is simply incorrect.[36] The Application does not cite a single case contesting the Court's principal holdings or demonstrating a departure from settled law. In fact, the Order clarified that Delaware courts "have ***not*** foreclosed the possibility of personal liability for trades executed by a controlled fund either."[37]

For example, in *Kahn*, plaintiffs alleged that directors of a sponsoring fund provided nonpublic information to that fund, which traded on that information.[38] The

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[34] *Id.*

[35] *Kahn*, 23 A.3d at 838 (citation omitted).

[36] Application at ¶22. Far from novel, the Court has held a fiduciary liable for the actions of its affiliated funds. *See, e.g.*, *In re PLX Tech. Inc. S'holder Litig.*, 2018 WL 5018535, at *49-50 (Del. Ch. Oct. 16, 2018). Even assuming arguendo that this is a matter of first impression—and it is not—the Supreme Court recently refused an interlocutory application where defendants' arguments raised an issue of first impression. *See U.S. Bank Nat'l Ass'n*, 2018 WL 5787230, at *1.

[37] *Fitbit*, 2018 WL 6587159, at *14 (emphasis added).

[38] *Kahn*, 23 A.3d at 835; *see also In re Primedia Inc. Deriv. Litig.*, 2010 WL 5621183 (Del. Ch. Mar. 26, 2010) (complaint alleging claims against KKR and its tippees on the Primedia board).

Supreme Court or the court below could have held, as a matter of law, that a director could not be liable for the improper trades of their affiliated funds.[39] Neither did and, in fact, the Court of Chancery noted that the "*Brophy* claim would have blown by a motion to dismiss."[40] In contrast, Fitbit fails to cite a single authority where a Delaware court has refused tippee liability.[41]

Delaware law dictates that the scope of recovery for a breach of the duty of loyalty is not to be determined narrowly.[42] The strict imposition of penalties under Delaware law are designed to discourage disloyalty.[43] Delaware has long endorsed the bedrock principle that where a fiduciary is alleged to have breached his duty of loyalty, the law "*extinguishes all possibility of profit flowing from a breach of the*

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[39] *Id.*

[40] *Kahn*, 23 A.3d at 842.

[41] Indeed, the Court concluded that "Plaintiffs' particularized allegations are sufficient at the pleading stage to allow a reasonable inference that Callaghan and Murray personally and materially profited from the challenged stock sales through their ownership and control of their affiliated funds." *Fitbit*, 2018 WL 6587159, at *14. Thus, proceeding to discovery is necessary to prove the degree to which Callaghan and Murray actually benefitted from the stock sales. *See TCV VI, L.P. v. TradingScreen Inc.*, 115 A.3d 1216 (Del. 2015) (declining interlocutory appeal and stating that "[i]t would be hazardous to decide those novel legal questions in the abstract, rather than against a concrete factual scenario").

[42] *Fitbit*, 2018 WL 6587159, at *14 (citing *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939)).

[43] *Id.*; *see also Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 445 (Del. 1996).

confidence imposed by the fiduciary relation."[44] Specifically, in the context of *Brophy*, the Order recognizes that "public policy will not permit an employee occupying a position of trust and confidence toward his employer to abuse that relation to his own profit, regardless of whether his employer suffers a loss."[45]

Fitbit seeks a second bite at the apple to advance a position that would turn Delaware's insider trading law on its head by advocating that a fiduciary should be permitted to engage in insider trading so long as the "entity with which he is affiliated (and over which he exercised control)" does "the trading."[46] The Order correctly held that "[t]his is not and cannot be our law."[47] To adopt such a rule would permit an "ostrich-like exception" and would be inconsistent with the Supreme Court's holding in *Kahn*, which provided that "*Brophy* focused on the public policy of preventing unjust enrichment based on the misuse of confidential corporate information."[48]

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[44] *Fitbit*, 2018 WL 6587159, at *14 (citing *Guth*, 5 A.2d at 510).

[45] *Fitbit*, 2018 WL 6587159, at *14 (citing *Brophy*, 70 A.2d at 8).

[46] *Id.*

[47] *Id.*; *see also Kandell v. Niv*, 2017 WL 4334149, at *16 (Del. Ch. Sept. 29, 2017) ("[T]his state does not 'charter lawbreakers.'").

[48] *Kahn*, 23 A.3d at 840.

II. THE FACT THAT INTERLOCUTORY APPEAL *MAY* TERMINATE THE LITIGATION IS NOT DISPOSITIVE.

Defendants next assert that interlocutory appeal is warranted because the Supreme Court's review *may* terminate the litigation if the Court's denial of the motion to dismiss is reversed.[49] This argument, standing alone, cannot justify the extraordinary practice of permitting an interlocutory appeal. Otherwise, anytime a motion to dismiss is denied in any derivative action, defendants would possess *carte blanche* to appeal on an interlocutory basis.[50]

III. INTERLOCUTORY APPEAL WILL NOT SERVE CONSIDERATIONS OF JUSTICE.

In considering an application for certification of interlocutory appeal, courts may consider whether immediate review will "serve considerations of justice."[51] Merely arguing that an interlocutory appeal will "avoid the costs of a possibly unnecessary and meritless lawsuit"[52] is not enough, as "such an argument can be

[49] Application at ¶28.

[50] Furthermore, the Supreme Court has repeatedly held that interlocutory applications should generally be denied when such requests are related to orders "directed to the pleadings." *Levinson v. Conlon*, 385 A.2d 717, 720 (Del. 1978); *accord Gardinier, Inc. v. Cities Serv. Co.*, 349 A.2d 744, 745 (Del. 1975) (same).

[51] Supr. Ct. R. 42(b)(iii)(H).

[52] Application at ¶27.

made in any action and cannot justify the extraordinary practice of interlocutory appeal."[53]

Despite Fitbit's contentions, this action is neither a "strike suit" nor "meritless." Plaintiffs undertook a thorough investigation of these claims before filing their actions including the pursuit of various Section 220 Demands. At present, this action has been pending for over twenty (20) months. Plaintiffs will face substantial prejudice if discovery is further delayed.[54]

Rather than "serving the interests of justice," interlocutory review here would result in the needless expenditure of time and resources by the Supreme Court and the parties and would delay the resolution of this action. For the motion to dismiss to be granted, the Supreme Court would have to ignore the totality of Plaintiffs' well-pleaded allegations in the complaint concerning scienter and disregard all logical inferences that flow from them. The Application also appears to only challenge Count II (*i.e.*, the *Brophy* claim). Even if the Order were reversed on appeal, Count

[53] *Nistazos Holdings, LLC v. Milford Plaza Enters., LLC*, 2016 WL 5408123, at *3 (Del. Ch. Sept. 26, 2016).

[54] *See, e.g.*, *Parfi Holding AB v. Mirror Image Internet, Inc.*, 954 A.2d 911, 928 (Del. Ch. 2008) (holding that an "unjust result" would result from undue delays in prosecuting case because, in part, "a less reliable record").

I would proceed.[55] This is precisely the type of fragmentation of litigation that a proper application of Rule 42 is intended to avoid.[56]

CONCLUSION

Nominal Defendant's Application for interlocutory certification should be refused.

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[55] Even if certification were to be granted (and it should not), and the Supreme Court reversed on Count II, Count I would still proceed for the reasons set forth in the PAB. *See* PAB at 56 (III.B. & IV.).

[56] *See E.I. du Pont de Nemours and Co. v. Allstate Ins. Co.*, 686 A.2d 1015, 1016 (Del. 1997) ("The goal, in all events, is to facilitate the orderly disposition of claims without inadvertently promoting a piecemeal approach to litigation."); *accord In re Pure Resources, Inc.*, 2002 WL 131357847, at *1 (Del. Ch. Oct. 9, 2002) (same).

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