

[Securities Regulation Daily Wrap Up, TOP STORY—Del. Sup. Ct.: Duke Energy D&Os evade coal ash lawsuit over Strine's dissent, \(Dec. 18, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

The Delaware Supreme Court dismissed a derivative *Caremark* action against the Duke Energy board for breach of fiduciary duties related to the 2014 coal ash spill. Presuit demand was not excused because, at most, the directors breached their duty of care, for which they were exculpated from liability. Chief Justice Strine dissented, excoriating Duke for its "business strategy ... to run the company in a manner that purposely skirted, and in many ways consciously violated, important environmental laws" ([City of Birmingham Retirement and Relief System v. Good](#), December 15, 2017, Seitz, C.).

Spill. The derivative plaintiffs filed suit in the wake of the 2014 disaster, which sent toxic coal ash and wastewater into the Dan River in North Carolina. In 2015, Duke pleaded guilty to criminal violations of the Federal Clean Water Act and paid a fine exceeding \$100 million. The complaint sought to hold certain directors and officers of Duke Energy liable for these and other damages that the company incurred following the spill. The plaintiffs argued that demand was futile because the board's mismanagement rose to the level of a *Caremark* violation, but the chancery court disagreed, reasoning that the plaintiffs failed to allege that the directors intentionally disregarded their oversight responsibilities to the point of bad faith.

Demand futility standard. Under Delaware's *Rales* test for demand futility, which applies to alleged violations of oversight duties under *Caremark*, plaintiffs must raise a reasonable doubt as to the board's independence and disinterest to evaluate a demand that would expose the board to a "substantial likelihood of personal liability." Because the Duke directors were exculpated from liability for due care violations, the plaintiffs were required to allege scienter with particularity.

Insufficient evidence of oversight violations, collusion. On appeal to the Supreme Court, the plaintiffs argued that the chancery court improperly discredited their interpretation of board presentations and minutes, which they claimed showed Duke was violating environmental laws and avoiding remediation. But the high court was not required to accept the plaintiffs' "unfair" construction of the presentations. Instead, the court's overall assessment was that the presentations were updates on environmental problems associated with coal ash disposal sites and steps Duke was taking to address the concerns. The court wrote that the plaintiffs "conflate the bad outcome of the criminal proceedings with the actions of the board."

The plaintiffs also argued that the chancery court failed to draw the proper inferences from the plaintiffs' alleged evidence of collusion between Duke Energy and its regulator, the North Carolina Department of Environmental Quality (DEQ). The Supreme Court noted that it would not be enough to allege cooperation with a "too-friendly" regulator; the plaintiffs were required to allege that Duke illegally colluded with a corrupt regulator, and then tie the improper conduct to an intentional oversight failure. The complaint fell short in several respects.

First, by focusing on the consent decree negotiated with DEQ and its "meaningless" \$99,000 fine (and no remediation), the plaintiffs isolated one part of a bigger picture. In addition to the fine, Duke estimated spending \$4 to \$5 million to enforce the decree at all North Carolina sites, as well as additional costs to identify and characterize seeps, conduct groundwater studies, and reroute flows or treatment. Duke also expected to negotiate a compliance schedule with regulators and remained vulnerable to not-yet-final EPA rules that could affect remediation costs. The fact that DEQ imposed a relatively small fine did not lead to an inference of corruption or that the board ignored evidence of alleged misconduct.

Furthermore, the consent decree was subject to state court approval, and the public and environmental groups that had intervened in the action were able to comment on and object to the decree before it took effect. The plaintiffs' allegations that DEQ generally did not aggressively enforce environmental laws did not lead to an inference of illegal collusion with Duke and the board's complicity. Several other statements and board minutes had innocuous implications. Finally, a federal decision holding that DEQ was not diligently prosecuting a case against Duke did not establish bad faith by the company or the board.

Strine's dissent. Chief Justice Strine dissented from the decision, finding that the allegations raised a pleading stage inference that it was Duke's business strategy to skirt and even consciously violate the environmental laws. "Duke's executives, advisors, and directors used all the tools in their large box to cause Duke to flout its environmental responsibilities, therefore reduce its costs of operations, and by that means, increase its profitability," Strine wrote.

The Chief Justice's primary disagreement was based in litigation procedure. Particularized pleading is required at this stage, but not conclusive proof. In his view, the plaintiffs do not yet have to prove collusion, merely facts supporting an inference that Duke was consciously violating the law, believing that its lack of good faith compliance "would be given a blessing by a regulatory agency whose fidelity to the law, the environment, and public health, seemed to be outweighed by its desire to be seen as protecting Duke and the jobs it creates." He supplied a list of facts supporting such an inference:

- The board knew that Duke illegally, and sometimes intentionally, discharged toxic water from its coal ash ponds into the groundwater;
- Testing dating back at least ten years confirmed that the coal ash ponds were contaminating groundwater at illegal levels;
- Duke's board continued to operate coal ash ponds without proper permits, sometimes with none at all;
- Duke and affiliated donors spent over \$1.4 million to secure the election of officials who would overlook violations, including a governor, Pat McCrory, who had been a longtime Duke employee;
- Duke's board supported the strategy to enlist DEQ (overseen by McCrory) to file complaints that preempted citizen suits seeking substantial remediation;
- Duke was caught illegally dumping wastewater into the Cape Fear River in amounts far exceeding what would be considered routine maintenance.

"Sadly," the Chief Justice came to the "reluctant conclusion that the facts as pled support a fair inference that the board was all too aware that Duke's business strategy involved flouting important laws, while employing a strategy of political influence-seeking and cajolment to reduce the risk that the company would be called to fair account."

The case is [No. 16, 2017](#).

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Companies: City of Birmingham Retirement and Relief System; Duke Energy Corporation

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