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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE KRAFT HEINZ COMPANY DERIVATIVE LITIGATION	))))	CONSOLIDATED C.A. No. 2019-0587-AGB PUBLIC VERSION E-filed: June 19, 2020

3G DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS CONSOLIDATED AMENDED VERIFIED STOCKHOLDER DERIVATIVE COMPLAINT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

Page(s)

OTHER AUTHORITIES

Page(s)

Defendants 3G Capital, Inc., 3G Capital Partners Ltd., 3G Capital Partners II LP, 3G Global Food Holdings GP LP, 3G Global Food Holdings LP, and HK3 18 LP (collectively, "3G") respectfully submit this opening brief in support of 3G's Motion to Dismiss the Consolidated Amended Verified Stockholder Derivative Complaint ("Complaint" or "CAC") under Court of Chancery Rules 23.1 and 12(b)(6). 3G expressly joins and incorporates herein by reference the opening brief filed by Nominal Defendant The Kraft Heinz Company ("Kraft Heinz" or "KHC") in support of Kraft Heinz's Motion to Dismiss the Complaint under Court of Chancery Rules 23.1 and 12(b)(6) ("KHC Mot.").

INTRODUCTION

3G is Kraft Heinz's second largest stockholder. In August 2018, 3G sold 7% of its stake in Kraft Heinz. Six months later, in February 2019, Kraft Heinz announced a $15.4 billion impairment charge to the value of its goodwill and intangible assets. Plaintiffs in this derivative action bring a so-called *Brophy* claim, alleging that 3G violated fiduciary duties it purportedly owed to Kraft Heinz by selling its stock when it did. Plaintiffs' theory is that 3G sold stock while in possession of material, nonpublic information ("MNPI") indicating that Kraft Heinz was at greater risk of future impairment than the market could have known, and that 3G's motive was to avoid a loss by cashing in on that MNPI. Neither contention is reasonably conceivable. Each one is foreclosed by established Delaware law and refuted by the very documents Plaintiffs rely on in their Complaint.

Plaintiffs' allegations about MNPI collapse under scrutiny. The heart of Plaintiffs' theory is that 3G knew about secret, supposed flaws in Kraft Heinz's recently completed impairment analysis that Plaintiffs contend foreshadowed an impairment six months later. Plaintiffs try to criticize that analysis—second-guessing management's judgments on a variety of grounds, all with the benefit of litigation-inspired hindsight—but MNPI is nowhere to be found, because it is plain that neither 3G, nor Kraft Heinz management more broadly, had any material insight that was unknown to the market. Plaintiffs' remaining MNPI allegations are even weaker. Plaintiffs allege that 3G somehow had special knowledge that Kraft Heinz had failed to meet expectations in recent years, that its cost savings might fall short of internal projections going forward, and that it was facing increased competition from private label retailers, including Walmart. All of this information was well known to the market; on none of these topics did 3G possess any material insight the market lacked. Finally, Plaintiffs allege that 3G knew Kraft Heinz had received a document preservation request from the SEC a few weeks before the stock sale, but there is no well-pled allegation that 3G knew that fact, and in all events, it is not material. These shortcomings require dismissal, as possession of MNPI is a prerequisite to liability under *Brophy*.

Plaintiffs' *Brophy* claim also must be dismissed for failure to plead scienter. Plaintiffs are required to plead facts permitting a reasonable inference that 3G sold stock because it was *motivated* to cash in on MNPI. But under settled precedent, neither the size nor the timing of 3G's sale—nor anything else alleged in the Complaint—permits that inference. 3G sold only 7% of its Kraft Heinz holdings, and this Court has routinely held that stock sales representing stakes significantly larger than that are too small to support an inference of illicit motives. And 3G sold stock only two business days after Kraft Heinz released its second quarter results, in line with Kraft Heinz's insider trading policy. As a matter of law, such timing is not suspicious. These conclusions are bolstered by 3G's public disclosure—which Plaintiffs overlook entirely—that the sale did not involve any Kraft Heinz shares originally held by partners of 3G. Dismissal for failure to plead scienter is amply justified.

BACKGROUND

For purposes of this motion only, 3G accepts as true any well-pled allegations in the Complaint, except insofar as they conflict with documents the Complaint incorporates by reference, including books and records Kraft Heinz produced to Plaintiffs under 8 *Del. C.* § 220, which are "expressly incorporated" into the Complaint. (CAC at 1); *e.g.*, *Reiter ex rel. Capital One Fin. Corp. v. Fairbank*, 2016 WL 6081823, at *2, 5-6, 9 (Del. Ch. Oct. 18, 2016).

A. Background On 3G And The Creation Of Kraft Heinz

3G is an investment partnership founded in 2004 by Alexandre Behring, Jorge Paulo Lemann, and Marcel Herrmann Telles, among others. (CAC ¶ 25.) 3G invests in several food and beverage companies, including Kraft Heinz and Restaurant Brands International (the parent company of Burger King, Tim Hortons, and Popeyes). (CAC ¶ 26.) 3G invests in businesses that it believes have sound fundamentals and maintains its positions for the long-term.

Kraft Heinz is one of the world's largest food and beverage companies. (CAC ¶ 53.) It was formed in July 2015 through the merger of Kraft Foods Group, Inc., a publicly traded company ("Kraft"), and The H.J. Heinz Company ("Heinz"), a private company that had been jointly owned by Berkshire Hathaway and 3G since 2013. (CAC ¶¶ 73, 3.) Berkshire Hathaway became Kraft Heinz's largest stockholder, owning 26.8%; 3G became its second largest stockholder, owning 24.2%; and the former stockholders of Kraft split the remaining 49%. (CAC ¶ 79.) The new Company was given an eleven-person Board of Directors, with five directors selected by Kraft, three (Warren Buffett, Gregory Abel, and Tracy Britt Cool) selected by Berkshire Hathaway, and three (Behring, Lemann, and Telles) selected by 3G. (CAC ¶¶ 72-73.) Behring became Chairman of the Board and served on the Compensation Committee and the Governance Committee. (CAC

¶ 34.) Lemann and Telles both also served on the Compensation and Governance Committees. (CAC ¶¶ 35, 137, 153.)

The Board appointed 3G partners Bernardo Hees and Paulo Basilio to serve as Kraft Heinz's first CEO and CFO, roles they had occupied at Heinz before the merger. (CAC ¶¶ 37, 75.) When Basilio became Kraft Heinz's U.S. Zone President in October 2017, the Board chose David Knopf, also a 3G partner, to replace him. (CAC ¶¶ 39, 75.)

B. Management's Disclosures And Kraft Heinz's Performance Following The Merger

A central question in this case is whether, when 3G sold stock in August 2018, it possessed MNPI that prefigured the impairment six months later. Answering that question requires comparing what 3G knew and what the market knew about the factors that affected Kraft Heinz's annual impairment test, the results of which Kraft Heinz released with its second quarter 10-Q on August 3, 2018, four days before 3G's stock sale. The 2018 annual impairment test is discussed in detail in Part C below. As explained there, and as Plaintiffs stress, the impairment test was based on several factors, including management's internal financial projections—in particular, projections about 2018 EBITDA—as well as Kraft Heinz's historical operating results and broader industry-wide and macroeconomic trends.

Concerning those topics, Plaintiffs focus primarily on Kraft Heinz's performance—and management's disclosures—between 2017 and the stock sale. As Plaintiffs acknowledge, by 2017 analysts were reporting that, since the merger, Kraft Heinz had underperformed expectations in important respects—and that despite achievements, the future included significant challenges. For example, according to a February 2017 *Wall Street Journal* article quoted in the Complaint (CAC ¶ 90), Kraft Heinz had "significantly improved its profitability since the 2015 deal that created the company," but it was "now running out of costs to cut." Saabira Chaudhuri & Annie Gasparro, *Failed $143 Billion Deal Raises Pressure on Unilever, Kraft*, The Wall Street Journal (Feb. 20, 2017), https://on.wsj.com/3famQAG. More disquietingly, as *Business Insider* reported in September 2017—in another article quoted in the Complaint (CAC ¶ 92)—Kraft Heinz had "not posted any sales growth since the 2015 merger." Graham Rapier, *Meet the 29-Year Old Who Was Just Named CFO of $100 Billion Giant Kraft Heinz*, Business Insider (Sept. 8, 2017), https://bit.ly/2z5ze4k. In fact, after the first quarter of 2017, analysts reported that Kraft Heinz's earnings "fell short of expectations," that "[o]rganic growth fell well short of expectations," and that "KHC failed to generate EBITDA growth for the first time as a combined public entity," and the following quarter analysts again described the Company's "EBITDA shortfall vs. Consensus." (Ex. 4 at 3G_003; Ex. 7 at 3G_001.)[1]

What Plaintiffs studiously ignore, however, is that Kraft Heinz openly discussed the Company's failure to meet expectations and the challenges ahead. In May 2017, during the Company's first quarter 2017 earnings call, Hees began his remarks by stating "[t]here is no doubt that the U.S. consumption was softer than expected," and that several factors caused "the overall consumer takeaway to be weaker than anticipated." (Ex. 3 at 3G_004.) Key among them were losses "in the Canadian retail market" stemming from contract renegotiations with several retailers, which led to "a double-digit decline in volume/mix." (*Id.* at 3G_004, 06, 10-11.) Likewise, George Zoghbi, the COO of Kraft Heinz's U.S. Commercial Business, conceded that "[t]here is no questioning the slow start to 2017 with greater-than-expected declines in January and February." (*Id.* at 3G_005.) On the same call, management faced pointed questions about whether its "approach to reducing costs may cut into multiple[s]" and whether "the cost savings are close to full and fully identified." (*Id.* at 3G_009-10, 11.)

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[1] Citations to "Ex. _" refer to Exhibits included in the Transmittal Declaration of Jacqueline A. Rogers in Support of the Opening Brief in Support of 3G's Motion to Dismiss Pursuant to Rules 12(b)(6) and 23.1, filed herewith.

Management also faced tough questions about competition from private label retailers. In August 2017—during the second quarter 2017 earnings call—one analyst highlighted "a number of categories [where] we've seen private label mix and inroads. Are you seeing that in any notable way in any of your categories in the U.S.?" (Ex. 5 at 3G_014.) Zoghbi replied, "[y]es, we are. There has been, as I said, a more pronounced focus in leading national retailers on increased private label total distribution point, merchandising, as a way to compete against discounters or separate themselves." (*Id.*) On the next earnings call—in November 2017—an analyst remarked that "we hear a lot from the retailers that private brands are growing, that the good retailers there, Wegmans, Costco, H-E-B, . . . have very, more developed private label programs and that others may want to catch up." (Ex. 8 at 3G_013.) Zoghbi confirmed the accelerating competition, answering, "[y]ou are right. This year, we have seen, after a long period of being flat, a renewed focus on expanding the total distribution points . . . of private label and some push on promoting private label as well." (*Id.* at 3G_013-14.)

At the beginning of 2018, management was clear—both internally and in its external messaging—that 2017 had been a disappointment in many respects, and that the year ahead would present challenges. When the Board met in January 2018, Hees "explained that while the Company fell short of its financial expectations, . . . there were many positive achievements during the year." (Ex. 10 at

KHC_PFRS_00001429.) The numbers bore that out. In 2017, EBITDA totaled about $8 billion—up 2.3% from 2016—but missed internal projections by nearly $500 million, or 5.2%. (Ex. 9 at KHC_PFRS_00001314-16.) Management predicted that 2018 EBITDA would grow by 4%, for a total of about $8.4 billion. (*Id.* at KHC_PFRS_00001338.)[2]

Consistent with his remarks to the Board, Hees's presentation on the fourth quarter 2017 earnings call, in February 2018, began by saying "there is no question our financial results in 2017 did not meet our potential. Did we deliver profitable sales and grow our bottom line? Yes. Did it deliver to our potential? No. We had a slow start, some missteps along the way," after which he detailed "4 key areas that held back our 2017 operation results." (Ex. 12 at 3G_004.) Knopf then disclosed that Canadian retail inventories "came in even lower than our initial expectations," and that Canadian retail challenges "look[] to be permanent, so this will likely translate into some headwinds moving forward." (*Id.* at 3G_006.) With respect to EBITDA, Knopf explained that "2 factors came into play during the quarter that

[2] Plaintiffs mistakenly claim that "[f]or fiscal year 2017, KHC missed its projected EBITDA of $7.97 billion by a staggering $530 million," and that "KHC projected EBITDA of $8.4 billion for fiscal year 2018—a $1 billion increase over the prior year." (CAC ¶¶ 4-5.) As explained above (and as the Complaint later acknowledges (CAC ¶ 106)), that $7.97 billion figure refers to Kraft Heinz's *actual* 2017 results, and thus Plaintiffs overstate management's expected 2018 increase by about half-a-billion dollars.

were not part of our outlook on our last call, and dampened year-over[-year]" results. (*Id.*) Knopf then cited multiple "higher-than-expected" and "unanticipated" costs, and reiterated that "our 2017 financials do not reflect our potential." (*Id.*)

Looking ahead, Kraft Heinz told the market to "[e]xpect Q1 decline" in EBITDA in 2018, but that management was hoping to achieve "progressively better growth as the year unfolds," with "gains" overall. (Ex. 13 at 3G_005.) Knopf elaborated that "EBITDA performance is likely to be skewed to the second half" of 2018, and that "investments, cost inflation," and "top line weakness in the U.S." would likely depress EBITDA during the first half of 2018. (Ex. 12 at 3G_007; *see also id.* at 3G_010-11.) Basilio confirmed that in the first quarter of 2018, at least, "sales" and "profit" were both "going to be soft." (*Id.* at 3G_010.)

The first quarter of 2018 bore out those predictions and inspired greater caution. When the Board met in April, it learned that quarterly EBITDA missed internal projections by $50 million, or 2.7%. (Ex. 16 at KHC_PFRS_00000943.) Hees told the Board that these results "were consistent with expectations for the quarter and that EBITDA was down largely due to key investments within the business to drive future growth and inflationary pressures within operations." (Ex. 17 at KHC_PFRS_00001157.) Basilio said that management was still expecting "strong performance in the second half compared to the first half of the year." (*Id.* at KHC_PFRS_00001159.) The Board learned that management had lowered its projected EBITDA for the year by about $350 million, to around $8 billion overall. (Ex. 16 at KHC_PFRS_00000963.)

Management's representations to the market mirrored those remarks. "At EBITDA," Hees explained during the earnings call on May 2, the first quarter's "near-term pressures" largely "played out as expected. And," he added, "we continue to expect many of the same factors to remain in Q2." (Ex. 19 at 3G_004.) Hees reiterated that management was projecting "an atypical balance of net sales and EBITDA between first half and second half in 2018," with hopes that strong second-half results would compensate for weaker first-half numbers. (*Id.* at 3G_006.) Knopf made the same point several times, telling analysts that EBITDA would be sluggish in the first half of 2018, but that management was forecasting a stronger performance in the third and fourth quarters, with "more than 1/2" of EBITDA for 2018 coming "in the second half" of the year. (*Id.* at 3G_007; *id.* at 3G_008, 10.) Knopf also indicated that management's outlook on EBITDA for the year had become more cautious. He said that management was still projecting "EBITDA growth" for 2018, but "to be clear," he added, "we're targeting EBITDA growth versus the revised 2017 base, following the new accounting standards we've implemented," which had caused Kraft Heinz to lower its 2017 EBITDA figures from nearly $8 billion to $7.77 billion. (*Id.* at 3G_008; Ex. 14 at 3G_011, 14; Ex. 11 at 3G_027, 49.)

In addition, analysts on the first quarter earnings call noted that Kraft Heinz's "brands have been wobbling in terms of their market share lately," and that "private label has been the beneficiary in some of these," which management did not deny. (Ex. 19 at 3G_009.) Finally, Knopf explained that it would be challenging for Kraft Heinz to achieve its expected cost savings going forward, because "inflation" and "accelerated investments" were likely to "run ahead of our savings curve." (*Id.* at 3G_011.)

The Board met next on August 2, 2018, five days before 3G's stock sale. Hees reported that although second quarter results "exceeded expectations laid out earlier in the year, . . . a lot of work remained for the year." (Ex. 31 at KHC_PFRS_00001301.) Knopf told the Board that "while EBITDA decreased during the quarter, it was better than expectations for the quarter discussed with the Board in April." (*Id.* at KHC_PFRS_00001302.) Looking ahead, management told the Board that it had revised its outlook on the second half of 2018, in what Plaintiffs refer to as the "2H18 Plan." (CAC ¶ 136.) Management no longer expected EBITDA to skew toward the second half of the year, and was now projecting a decline of 1% overall. (Ex. 29 at KHC_PFRS_00001265.) In total, management had lowered its 2018 projected EBITDA by $248 million from the previous quarter, and was now projecting $7.67 billion overall. (*Compare id.* at KHC_PFRS_00001268 *with* Ex. 16 at KHC_PFRS_00000963.) The Board also discussed accelerating inflation and increasing retail competition, including private-label competition from Walmart and others. (Ex. 29 at KHC_PFRS_00001262-64; Ex. 31 at KHC_PFRS_00001302-03.)

Kraft Heinz's second quarter earnings call—on August 3, 2018, four days before 3G's stock sale—described all of these concerns. Management told the market that its outlook on the year had dampened in critical respects, even though the quarter itself had exceeded expectations in some ways. Importantly, Knopf told the market that management had significantly lowered its expectations with respect to 2018 EBITDA, even compared to the expectations it held as of the previous earnings call, in May. Whereas management previously forecasted a strong second-half EBITDA that would offset weak first-half results, Knopf explained that management now thought it was "appropriate to be more conservative in the near term with expectations around adjusted EBITDA. And instead of the second half skew that we previously talked about, we now expect more of a 50-50 split to the year." (Ex. 33 at 3G_007.) With respect to "Q3 prospects" specifically, Knopf explained that, in management's revised forecast, EBITDA was "likely to be down a greater order of magnitude than what we saw in the first half of the year," when EBITDA was already down 3.6% from 2017. (*Id.*; Ex. 32 at 3G_042.) Knopf made these points—that management had lowered its expected 2018 EBITDA, and was now projecting a weak third quarter and a roughly "50-50 split to the year"—no fewer than *three times* on that call. (Ex. 33 at 3G_007, 11, 13.)

Of course, the market knew exactly how much EBITDA Kraft Heinz had generated in the first half of the year: the second quarter 10-Q, released the same day as the earnings call, disclosed that Kraft Heinz's first-half EBITDA was $3.77 billion. Given Knopf's repeated explanation that management was now projecting EBITDA to be "50-50" for the year, the market knew that management was now projecting 2018 EBITDA to total less than $7.6 billion, down about 5% from 2017. If anything, Knopf erred on the side of giving the market a slightly more cautious outlook than management held, because as noted above, management was projecting 2018 EBITDA to total $7.67 billion. (Ex. 29 at KHC_PFRS_00001268; CAC ¶ 157.)

These disclosures were not lost on the market. A Goldman Sachs analyst said that he was "interpreting [Knopf's comments] to mean that you're lowering your full-year EBITDA guidance by about $300 million" compared to the "[l]ast quarter. . . . Is that wrong?" (Ex. 33 at 3G_013.) Far from saying the analyst was wrong, Knopf again explained why management now thought it was "best to . . . head into the second half with a more conservative set of expectations around near-term EBITDA dollars, especially for Q3." (*Id.* at 3G_014.) That disclosure accurately described management's revised projections. (*See* CAC ¶ 232 (alleging management lowered 2018 EBITDA projections by $248 million between end of Q1 and end of Q2).)

EBITDA was not the only topic where management disclosed that its forecasts had dimmed. Consistent with management's presentation to the Board, Knopf acknowledged that expected cost savings were becoming increasingly difficult to achieve. As he put it, "we're seeing additional cost inflation that in the immediate term is outpacing the savings curve." (Ex. 33 at 3G_014.) He made that point three times during the call. (*Id.* at 3G_007, 11, 14.) And on the topic of increased private-label retail competition—which had been discussed repeatedly on previous calls—one analyst mentioned "Walmart taking as much volume share as they are," which management did not deny. (*Id.* at 3G_014.)

C. Kraft Heinz's 2018 Annual Impairment Assessment

As mentioned above, Kraft Heinz released its second quarter 10-Q on August 3, 2018, four days before 3G's stock sale. That 10-Q disclosed the results of Kraft Heinz's annual impairment test of its goodwill and intangible assets. The 10-Q explained that "as of June 30, 2018," Kraft Heinz's "goodwill balance consists of 20 reporting units and had an aggregate carrying value of $44.3 billion," and its "indefinite-lived intangible assets primarily consist of a large number of individual brands and had an aggregate carrying value of $53.4 billion." (Ex. 32 at 3G_015-16.) With respect to both goodwill and intangible assets, Kraft Heinz explained that "[w]e test . . . for impairment at least annually in the second quarter or when a triggering event occurs." (*Id.*)

Testing a brand or reporting unit for impairment requires estimating its "fair value"—*i.e.*, the price at which it could be sold on the open market—and comparing that figure to its "carrying amount," *i.e.*, its value as reflected on a balance sheet. As Kraft Heinz explained, if a brand or reporting unit's "carrying amount exceeds its fair value," the Company "will record an impairment charge based on that difference." (*Id.* at 3G_009.)

As Kraft Heinz also explained, estimating a brand or reporting unit's fair value is a judgment-laden exercise—not a mechanical calculation—that requires making a variety of assumptions that are inherently uncertain. According to the 10-Q, "[f]air value determinations require considerable judgment and are sensitive to changes in underlying assumptions, estimates, and market factors." (*Id.* at 3G_016.) In particular, Kraft Heinz explained, estimating fair value "requires us to make assumptions and estimates regarding our future plans, as well as industry and economic conditions," and "financial forecasts." (*Id.* at 3G_015-16.) And Kraft Heinz made clear that "[i]f our current assumptions and estimates, including future annual net cash flows, [royalty rates, contributory asset charges,] income tax rates, and discount rates, are not met, or if valuation factors outside of our control change unfavorably, the estimated fair value of our goodwill [or intangible assets] could be adversely affected, leading to a potential impairment in the future." (*Id.* at 3G_016.)

In this instance, like in prior years, Kraft Heinz disclosed that "[w]e performed our 2018 annual impairment test as of April 1, 2018." (*Id.* at 3G_015, 16; *see* Ex. 6 at 3G_013; Ex. 1 at 3G_013-14.) As in years past, Kraft Heinz hired KPMG to conduct certain fair value analyses in connection with the assessment, and PricewaterhouseCoopers ("PwC") to audit the assessment and related disclosures. (CAC ¶¶ 138, 151; Ex. 22 at KHC_PFRS_00000705.) Consistent with the description in Kraft Heinz's second quarter 10-Q, KPMG's fair value analyses relied on "[m]anagement's forecasts of future business operations"—including a forecasted 2018 EBITDA of $7.98 billion—as well as KPMG's own "analyses of [Kraft Heinz's] historical operating results," its "review of the industry in which [Kraft Heinz] operates," its "research of publicly-traded guideline companies," and various "economic, financial, and other analyses" conducted by KPMG. (Ex. 15 at KHC_PFRS_00003891, 3938.)

In the second quarter 10-Q, Kraft Heinz disclosed the results of its impairment assessment. Kraft Heinz recognized two impairments: a Brazilian brand called Quero was impaired by $101 million, and the combined Australia & New Zealand reporting unit was impaired by $164 million. (Ex. 32 at 3G_015-16.) The 10-Q also disclosed that four reporting units and two brands "each had excess fair value over its carrying value"—otherwise known as a fair value "cushion"—"of less than 10%," which created a high enough risk of future impairment that management decided an early warning disclosure was justified. (*Id.*) The at-risk reporting units were Canada Retail, Latin America Exports, Northeast Asia, and Southeast Asia, and the at-risk brands were ABC and Smart Ones. (*Id.*)

Importantly, as explained in an Ernst & Young impairment manual quoted in the Complaint (CAC ¶ 133), neither GAAP nor the SEC sets a specific requirement about when a fair value cushion is low enough to warrant an early warning disclosure. The most guidance companies are given is that "[t]he SEC staff frequently asks registrants to discuss . . . the possibility of future impairment of goodwill for any reporting unit that may have a material amount of goodwill 'at risk,'" which "may" be the case if its "fair value . . . is not *substantially in excess* of its carrying amount at the assessment date. While no bright-lines exist to determine whether the fair value was not substantially in excess of the carrying amount and thus a reporting unit's goodwill is considered 'at risk,' the SEC staff has stated that it expects a registrant to apply judgment when making those disclosures." Ernst & Young LLP, *Financial Reporting Developments: A Comprehensive Guide* 166-67 (April 3, 2020) (emphasis added), https://go.ey.com/3daLIGN.

As the 10-Q reflected, Kraft Heinz's policy was to disclose any brand or reporting unit whose fair value cushion was less than 10%. (CAC ¶ 144.) That policy was consistent with guidance Kraft Heinz received from its independent outside auditors at PwC, who advised that "reporting units and tradenames [whose] fair value exceeds the carrying value by less than 10% . . . are considered close call judgments." (Ex. 24 at KHC_PFRS_00001912.) Before Kraft Heinz issued its second quarter 10-Q, PwC "reviewed management's disclosures around impairments and close calls," and noted that "management has included disclosure foreshadowing the risk of a future impairment" for all of the "close call judgments." (*Id.*)

D. 3G's August 7, 2018 Stock Sale

On August 7, 2018, 3G sold about 20.6 million shares of Kraft Heinz stock, representing 7% of its stake in the Company. (CAC ¶ 169.) This sale was the third time 3G had sold a modest portion of its Kraft Heinz holdings in the three years since the merger. On September 19 and 20, 2016, 3G sold a combined 2.8 million shares, or about 1% of its holdings. (Ex. 2; CAC ¶ 170.) The August 2018 sale occurred on one of the first days allowed under Kraft Heinz's insider trading policy, which barred trading from the second-to-last Friday of each quarter until "[i]mmediately following the completion of one full trading day after Kraft Heinz issues its earnings release." (Ex. 18 at KHC_PFRS_00003398.) Kraft Heinz's legal department approved the sale. (CAC ¶¶ 168, 171.) According to the Form 4 that 3G filed in connection with the sale, which is cited in the Complaint (CAC ¶ 177), the sale "did not include any Shares related to the original interest of the partners of 3G Capital Partners in . . . The Kraft Heinz Company." (Ex. 34 at 3G_002 n.3.) The Complaint overlooks that representation. 3G undertook the sale in order to satisfy redemption requests submitted by Limited Partner investors in a fund called 3G Kraft Heinz Company Holdings LP. These requests were all submitted by June 30, 2018, as required by the fund's Limited Partnership Agreement. 3G did not receive any portion of the proceeds from the sale, whether in the form of carried interest or otherwise, and 3G did not charge a management fee. Furthermore, no 3G partner affiliated with Kraft Heinz owned any of the shares included in the sale, and no such partner received any portion of the proceeds from the sale.

E. Kraft Heinz's February 2019 Announcements

On February 21, 2019, Kraft Heinz announced its earnings for the fourth quarter of 2018. The announcement also reported that, during the fourth quarter, Kraft Heinz recognized non-cash impairment losses of $15.4 billion, out of approximately $100 billion, to goodwill and intangible assets. (Ex. 36 at 3G_005.) These losses were spread across five reporting units—U.S. Refrigerated, Canada Retail, Latin America, Northeast Asia, and Southeast Asia—and five brands, namely Kraft, Oscar Mayer, Philadelphia, Velveeta, and ABC. (Ex. 37 at 3G_002-03.) As noted above, Kraft Heinz's second quarter 2018 10-Q included early warning disclosures that four of those reporting units (Canada Retail, Latin America, Northeast Asia, and Southeast Asia), and one of those brands (ABC), were at heightened risk of impairment because their fair value cushions were less than 10%. Kraft Heinz explained that several factors led it to conduct an interim impairment test in the fourth quarter of 2018, including a sustained decrease in the Company's stock price in November and December, fourth-quarter results that fell below management's expectations, and the approval of the Company's 2019 annual operating plan in December 2018. (*Id.* at 3G_002.)

Kraft Heinz also reported that it had received a subpoena from the SEC in October 2018 "associated with an investigation into the Company's procurement area." (Ex. 36 at 3G_007.) That subpoena followed a related document preservation request the SEC sent Kraft Heinz in July 2018. (CAC ¶ 140.) The investigation ultimately led Kraft Heinz to announce, in May 2019, that its financial statements from 2015 to 2018 would be restated to reflect $208 million in cumulative increases to its previously reported $63.7 billion in cost of products sold during that period—a change of less than 0.33%. (*See* CAC ¶ 227; Ex. 39 at 3G_003; Ex. 36 at 3G_012; Ex. 11 at 3G_054.) Kraft Heinz determined that these adjustments were not quantitatively material in any quarter, with the largest being an increase of $38 million in the third quarter of 2017. (Ex. 39 at 3G_003.)

Following the February 21 announcements, Kraft Heinz's share price fell 27.46%, from $48.18 to $34.95 per share. (CAC ¶ 208.)

F. Plaintiffs' Allegations

Plaintiffs in this derivative action allege that 3G's August 2018 stock sale constituted a breach of fiduciary duty under *Brophy v. Cities Service Co.*, 70 A.2d 5, 8 (Del. Ch. 1949). (CAC ¶¶ 237-40.) To state a *Brophy* claim, "[t]he plaintiff must show that: '1) the corporate fiduciary possessed material, nonpublic company information; and 2) the corporate fiduciary used that information improperly by making trades because she was motivated, in whole or in part, by the substance of that information.'" *Kahn v. Kolberg Kravis Roberts & Co., L.P.*, 23 A.3d 831, 838 (Del. 2011).

Plaintiffs list several types of MNPI that 3G allegedly possessed at the time of its August 2018 stock sale. (CAC ¶¶ 12, 175.) These MNPI allegations can be grouped into the following five categories:

1. That Kraft Heinz's 2018 annual impairment assessment contained flaws that masked looming impairments to reporting units and brands;
2. That Kraft Heinz had underperformed management's expectations for over a year;
3. That Kraft Heinz was unlikely to achieve management's internal cost-saving projections going forward;
4. That Kraft Heinz was facing steep private-label competition from Walmart and others, and additional challenges in Canadian retail; and
5. That the SEC had sent Kraft Heinz a document preservation request in July 2018 related to its procurement function.

In addition, Count II of the Complaint seeks contribution and indemnification against 3G and others for losses arising out of a federal securities action currently pending in federal district court against Kraft Heinz, several of its officers and directors, and 3G. (CAC ¶¶ 241-53.) Count III alleges that 3G and various Kraft Heinz officers and directors are liable for aiding and abetting each other's alleged breaches of fiduciary duty. (CAC ¶¶ 254-57.)

PLEADING STANDARD

"In deciding a motion to dismiss under Rule 12(b)(6), a trial court must accept as true all of the well-pleaded allegations of fact and draw reasonable inferences in the plaintiff's favor. A trial court is not, however, required to accept as true conclusory allegations 'without specific supporting factual allegations.' Moreover, a trial court is required to accept only those 'reasonable inferences that logically flow from the face of the complaint' and 'is not required to accept every strained interpretation of the allegations proposed by the plaintiff.'" *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006). Dismissal is proper where "the 'plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances.'" *Id.*

Plaintiffs received a large production of books and records from Kraft Heinz under Section 220. The Complaint cites those materials extensively and declares that "all of" them "are expressly incorporated by reference in this Complaint." (CAC at 1.) The Court may consider those documents in ruling on this motion, along with the SEC filings and other extrinsic materials relied upon in the Complaint, and other judicially noticeable documents that establish what Kraft Heinz disclosed to the market. *Gen. Motors*, 897 A.2d at 169-71; *Fairbank*, 2016 WL 6081823, at *2, 5-6, 9; *In re Gardner Denver, Inc.*, 2014 WL 715705, at *9 (Del. Ch. Feb. 21, 2014).

ARGUMENT

Delaware law "sets the bar for stating a claim for breach of fiduciary duty based on insider trading very high." *In re Clovis Oncology, Inc. Derivative Litig.*, 2019 WL 4850188, at *15 (Del. Ch. Oct. 1, 2019). The allegations here come up well short. First, Plaintiffs have not properly alleged that 3G was in possession of any MNPI at the time of its August 2018 stock sale. The Complaint itself, and the documents it incorporates by reference, make clear that every piece of alleged MNPI in the Complaint was either known to the market at the time of the sale, was not material, and/or is not properly alleged to have been known to 3G. Second, the Complaint fails to create a reasonable inference of scienter, because nothing in the Complaint suggests that 3G sold a small fraction—7%—of its Kraft Heinz holdings based on a motive to take advantage of MNPI. Furthermore, the Complaint fails to plead that 3G, a minority stockholder, was a Kraft Heinz fiduciary, which alone is dispositive under *Brophy*. The Court must also dismiss Count II (for contribution and indemnification) as unripe and because 3G is not a controlling stockholder, and

Count III (for aiding and abetting) because Plaintiffs have failed to plead an underlying breach of fiduciary duty. All of these defects are in addition to Plaintiffs' failure to plead demand futility, which independently requires dismissal under Rule 23.1 for the reasons explained in Kraft Heinz's motion to dismiss.

I. THE COMPLAINT FAILS TO ALLEGE THAT 3G SOLD STOCK WHILE IN POSSESSION OF MNPI.

The Complaint alleges that 3G possessed several classes of MNPI at the time of the August 2018 stock sale. (CAC ¶¶ 12, 175.) These MNPI allegations can be grouped into five categories: (1) that 3G knew about secret, supposed flaws in Kraft Heinz's 2018 annual impairment assessment, which concealed from the market that several brands and reporting units were on the brink of impairment; (2) that 3G knew Kraft Heinz had fallen short of management's expectations going back to 2017; (3) that 3G knew of a realistic possibility that Kraft Heinz would fail to achieve management's internal projected cost savings going forward; (4) that 3G knew Kraft Heinz was facing increased competition from Walmart and other private label retailers, and faced difficulties with Canadian retailers; and (5) that 3G knew Kraft Heinz received a procurement-related document preservation request from the SEC.

These categories will be discussed in turn. But whether considered individually or together, they entirely fail to allege that 3G sold stock with any material informational advantage over the market.

A. The Complaint Fails To Allege That 3G Possessed MNPI About Kraft Heinz's 2018 Annual Impairment Assessment.

As explained in detail above, Kraft Heinz's second quarter 10-Q—released on August 3, 2018, four days before 3G's stock sale—told the market that Kraft Heinz tested its reporting units and brands for impairment "as of April 1, 2018." (Ex. 32 at 3G_015, 16.) The 10-Q also disclosed the results of that analysis: one reporting unit (Australia & New Zealand) and one brand (Quero) were impaired, while four reporting units (Canada Retail, Latin America Exports, Northeast Asia, and Southeast Asia) and two brands (ABC and Smart Ones) had fair value cushions of less than 10%. (*Id.*)

The heart of the Complaint is Plaintiffs' allegation that 3G sold stock because it was aware of flaws in that impairment analysis that the market could not have known about and that led Kraft Heinz to announce a $15.4 billion impairment charge six months later. These allegations fall into two broad categories. First, Plaintiffs allege that 3G knew—and the market did not know—that the impairment analysis was based in part on financial projections that management had since revised to be more conservative. Second, Plaintiffs allege that 3G knew that Kraft Heinz management had failed to perform alternative analyses that would have revealed higher risks of impairment. Plaintiffs try to shore up these allegations by pointing to an impairment-related memo circulated by Kraft Heinz's Global Controller, Vince

Garlati, at the end of July, and by drawing attention to a revised bonus formula that the Compensation Committee put in place during the second quarter. None of these allegations withstands scrutiny.

1. 3G did not have MNPI about the nature of the projections underlying Kraft Heinz's 2018 annual impairment assessment.

A major pillar of the Complaint is Plaintiffs' allegation that 3G knew Kraft Heinz's impairment analysis was faulty because 3G knew that the impairment test was based on "stale" EBITDA projections supplied to KPMG by Kraft Heinz management. (*E.g.*, CAC ¶¶ 8, 10-12, 138-39, 144, 148, 175.) This allegation is refuted by the very documents the Complaint incorporates by reference.

As an initial matter, the impairment analysis was not based on "stale" EBITDA projections. (CAC ¶ 138.) KPMG's fair value analysis used management's projections as of April 2018, and the Complaint acknowledges that in April 2018, in response to Kraft Heinz's first quarter results, management adjusted those projections downward, "from $8.4 billion to approximately $8 billion." (CAC ¶ 118.) That revised number matched the $7.98 billion 2018 EBITDA projection KPMG used. (CAC ¶ 138; Ex. 15 at KHC_PFRS_00003938.)

In any event, even if the EBITDA projections underlying the impairment analysis could be characterized as "stale" by the time of 3G's stock sale, it still would not demonstrate that 3G traded while in possession of MNPI. As recounted in detail above and as further explained below, at the time of 3G's stock sale, the market knew that Kraft Heinz performed its impairment analysis using EBITDA projections that management formulated in April, and the market also knew that management had since lowered those projections by some $300 million. Yet that is the precise information Plaintiffs claim Kraft Heinz and 3G kept secret. (*E.g.*, CAC ¶¶ 8, 10-12, 21, 138-39, 144, 148, 167, 175.)

In its second quarter 10-Q, Kraft Heinz stated that "[w]e performed our 2018 annual impairment test as of April 1, 2018," and it explained that the impairment test relied on "financial forecasts," "assumptions," and "estimates" that were all "current" as of that date. (Ex. 32 at 3G_015, 16.) The market knew what that meant, because the market knew that as late as May 2, management was targeting "positive constant currency EBITDA growth . . . for the full year . . . versus the revised 2017 base" of $7.77 billion. (Ex. 19 at 3G_008; Ex. 14 at 3G_011, 14; Ex. 11 at 3G_027, 49.) Thus, by the time of 3G's stock sale, the market knew that Kraft Heinz had performed its impairment test while management was projecting somewhere on the order of $8 billion in EBITDA for 2018.

And the market *also* knew that between the time Kraft Heinz conducted the impairment test and the time of 3G's stock sale, management had lowered its internal 2018 EBITDA projections by around $300 million, and was now projecting less than $7.6 billion in EBITDA for the year overall. As recounted above, on the second quarter earnings call—four days before 3G's sale—Knopf repeatedly told the market that Kraft Heinz was no longer expecting EBITDA growth for the full year, but instead was expecting 2018 EBITDA to have about a 50-50 split between the first and second halves of the year. (Ex. 33 at 3G_007, 11, 13.) And the market knew that Kraft Heinz's EBITDA for the first half of 2018 was $3.77 billion. (Ex. 32 at 3G_055.) In other words, Knopf accurately told the market that management had grown more conservative and was now projecting EBITDA for 2018 to total somewhere around $7.6 billion. (*See* CAC ¶¶ 138, 232 (alleging that, at time of 3G's stock sale, management was projecting 2018 EBITDA of $7.67 billion).)

The market understood all that. In response to Knopf's presentation, a Goldman Sachs analyst said that he was "interpreting this to mean that you're lowering your full-year EBITDA guidance by about $300 million" compared to the guidance management gave after the first quarter; "Is that wrong?" (Ex. 33 at 3G_013.) Knopf did not say he was wrong; instead, Knopf explained why he was right. (*Id.*; CAC ¶ 232 (alleging management lowered internal 2018 EBITDA projections by $248 million between the end of the first and second quarters).)

These indisputable, judicially noticeable facts refute the Complaint's central allegation, namely, that 3G possessed MNPI because only 3G knew that Kraft Heinz's just-completed impairment analysis rested on EBITDA projections that management had since lowered by several hundred million dollars. Furthermore, there is no basis whatsoever to suppose that anyone from 3G knew what the results of a counterfactual, second impairment analysis would have been if management had instructed KPMG to conduct a new impairment test using the revised projections at the end of the second quarter. In fact, Plaintiffs concede—as they must—that "no one updated the [impairment] analysis" to account for management's more conservative outlook. (CAC ¶ 144.) The Complaint's central MNPI allegation evaporates in light of the above.

2. 3G did not have MNPI about what alternative impairment analyses purportedly would have shown.

Plaintiffs spend much of the Complaint criticizing Kraft Heinz's impairment analysis, apparently in the hope of suggesting that 3G knew about other flaws that were supposedly hidden from the market and that augured the impairment six months later. These allegations read like an abandoned *Caremark* claim repackaged as a *Brophy* claim; that is, they focus on what Plaintiffs allege 3G *could have* known, as opposed to what 3G *did* know. But that is not viable. At bottom Plaintiffs offer an even less tenable version of the *Brophy* theory that this Court roundly rejected in *Oracle*, where it refused "[t]o subject corporate insiders to a possible disgorgement remedy under our law whenever a court, in hindsight, concludes that the insiders should, under some type of due care standard, have suspected that their company would later miss the mark." *In re Oracle Corp.*, 867 A.2d 904, 930-31 (Del. Ch.

2004). Although Plaintiffs aim to impugn Kraft Heinz's impairment assessment—raising a variety of supposed faults, all with the benefit of "litigation-inspired hindsight," *id.* at 908—these allegations fail to demonstrate that 3G had a material informational advantage at the time it sold stock.

Plaintiffs stumble out of the gate by trying to create a whiff of scandal around the resignation of Chris Skinger, Kraft Heinz's Chief Accounting Officer, only to get the relevant timeline wrong. Plaintiffs allege that "[m]anagement informed the Audit Committee on June 18, 2018 that KHC would be taking impairment charges . . . for its Australia and New Zealand reporting unit and for one brand in Brazil," and that Skinger "resigned and left the Company a few hours after that meeting." (CAC ¶ 7; *see also* CAC ¶ 134.) But for one thing, management did not tell the Audit Committee about those impairments until July 31. (*Compare* Ex. 22 at KHC_PFRS_00000705-08, Ex. 23 at KHC_PFRS_00000760-66 *with* Ex. 24 at KHC_PFRS_00001814-18, Ex. 25 at KHC_PFRS_00001938.) And for another, Kraft Heinz announced Skinger's resignation publicly on June 6—nearly two weeks before the disclosure Plaintiffs imagine—and he stayed at the Company until at least June 28, his resignation being in no way suspicious. (Ex. 20; Ex. 21.)

Plaintiffs' case does not improve from there. Plaintiffs allege—with all the benefits of hindsight—that "[e]ven small changes to KHC's valuation models would have required KHC to impair and/or make early warning disclosures." (CAC ¶ 147.)

Plaintiffs offer very little to follow through on that charge. Their best example is the risk-free "20-year Treasury Bond yield" rate, which "went up 22 basis points" between April 1 and August 1, 2018. (*Id.*) Plaintiffs allege that if the impairment test had used the August 1 rate instead of the April 1 rate, it would have shown the U.S. Refrigerated reporting unit as having a fair value cushion below 10%. (*Id.*)

This allegation provides no basis to conclude that 3G traded while in possession of MNPI. As already discussed, the market knew that Kraft Heinz's impairment analysis was conducted as of April 1, so it was obviously not MNPI that the August 1 risk-free rate was not part of the test. In addition, there is no well-pled allegation that anyone from 3G knew that performing a second impairment test, using the August 1 risk-free rate, would have led to an early-warning disclosure for U.S. Refrigerated. Indeed, management was not even responsible for setting the risk-free rate; the U.S. Treasury was, and KPMG incorporated it into its fair value analyses without relying on anything supplied by management. (Ex. 15 at KHC_PFRS_00003917.) This allegation—like much else in the Complaint—is another impermissible attempt to plead fraud by hindsight. As this Court has explained, *Brophy* claims cannot be premised "on what the plaintiffs, in litigation-inspired hindsight, argue that [the defendants] should have done, but did not do, to analyze the information they received before their trades." *Oracle*, 867 A.2d at 908.

On a similar theme, Plaintiffs assail the impairment test's use of a 7% discount rate to determine the fair value of North American reporting units. (CAC ¶ 150.) Plaintiffs allege that "[m]anagement provided no rationale" to the Audit Committee for using a rate "sufficiently small to keep the fair value cushions just above 10%." (*Id.*) What Plaintiffs appear to be saying is that if management had used a higher—but unspecified—discount rate, then some—unspecified—North American reporting units would have been closer to impairment, perhaps close enough to trigger an early warning disclosure.

This allegation again does not move the *Brophy* needle because Plaintiffs do not even attempt to allege that anyone from 3G knew what an impairment analysis would have shown had it been conducted using an alternative (unspecified) discount rate. These allegations therefore shed no light on whether 3G traded while in possession of MNPI. Moreover, as was true with respect to the above-referenced risk-free rate, management was not responsible for setting discount rates; KPMG was, and it did so by relying almost exclusively on inputs derived from external sources, and did not use any financial projections supplied by management. (Ex. 15 at KHC_PFRS_00003917-20.) In other words, there is no basis to infer that someone from Kraft Heinz tried to manipulate the discount rate used by KPMG. More to the point, even if some unidentified Kraft Heinz employee had done so, there is zero ground to suppose that anyone from 3G knew or could have known about it. Hence, once again, Plaintiffs are trying to reverse engineer an impairment warning, but these allegations provide no basis whatsoever to conclude that 3G traded while in possession of MNPI.

Some of the Complaint's allegations affirmatively undercut Plaintiffs' case. Consider the allegations about the July 31 Audit Committee meeting, when management and PwC presented the results of the 2018 impairment test—*i.e.*, that there were impairments to the Australia & New Zealand reporting unit and the Quero brand, and that four reporting units and two brands had fair value cushions below 10%. (CAC ¶ 134; Ex. 24 at KHC_PFRS_00001818, 1825, 1912.) (Plaintiffs mistakenly claim that this presentation occurred during the June 18 Audit Committee meeting. (CAC ¶ 134.)) Plaintiffs allege that "[n]either management nor the Audit Committee, however, discussed whether KHC should perform any further analysis or run any sensitivities on the U.S. or Canadian reporting units. Those U.S. and Canadian reporting units were by far KHC['s] biggest and most important units and ultimately accounted for the vast majority of the eventual $15.4 billion impairment." (*Id.*) Plaintiffs make a similar allegation about the August 3 Board meeting. (CAC ¶ 144.)

These allegations discredit Plaintiffs' overarching *Brophy* claim, namely, that 3G somehow knew that alternative impairment analyses would have shown that Kraft Heinz was at a materially greater risk of impairment than the market appreciated. As Plaintiffs are forced to admit, there is no basis to suggest that anyone from 3G (or anyone period) performed those alternative analyses, and hence no basis to suggest that 3G traded while in possession of MNPI. Here as elsewhere, Plaintiffs ignore that a *Brophy* claim cannot hinge on analysis 3G neither performed nor received; *Brophy* (unlike *Caremark*) is concerned with information 3G *had*, not information that Plaintiffs believe good governance required the Board or Audit Committee to obtain (about which there is no, and there can be no, claim).

3. The disclosures in the "Garlati Memorandum" do not support Plaintiffs' MNPI allegations.

The Complaint notes that on July 31, 2018, Vince Garlati, Kraft Heinz's Global Controller, sent a memo to the Audit Committee (copying the Board) that discussed the results of the annual impairment analysis. (CAC ¶¶ 8, 143, 176(b).) Garlati's memo stated that two unnamed reporting units and eight unnamed brands had fair value cushions of more than 10% but less than 20%. (Ex. 24 at KHC_PFRS_00001825.) The next day, Garlati presented the Audit Committee with a table showing the fair value, carrying amount, fair value cushion, and other data for each of Kraft Heinz's 51 brands and reporting units. (Ex. 26 at KHC_PFRS_00000781-83.) This presentation did not call attention to any brands or reporting units whose fair value cushions exceeded 10%, including those with cushions between 10% and 20% (of which there were actually four reporting units and eight brands). (*Id.* at KHC_PFRS_00000780-83; Ex. 27 at KHC_PFRS_00000912-13.) Rather, consistent with Kraft Heinz's disclosure policy, Garlati singled out only those brands and reporting units that were impaired or had fair value cushions of less than 10%. (Ex. 26 at KHC_PFRS_00000780-83; Ex. 27 at KHC_PFRS_00000912-13.) As explained above, Kraft Heinz disclosed all of those brands and reporting units in its second quarter 10-Q, four days before 3G's stock sale. (Ex. 32 at 3G_015-16.)

Plaintiffs do not allege that 3G possessed MNPI simply because it had information indicating that some brands and reporting units had fair value cushions between 10% and 20%. That allegation would not be viable in any event. In the first place, there were twelve brands and reporting units with fair value cushions between 10% and 20% at the time of the trade, but only five of them were impaired by February 2019. (*Compare* Ex. 26 at KHC_PFRS_00000781-83 *with* Ex. 37 at 3G_002-03.) This mixed record, showing significant fluctuations across this metric, underscores why *Brophy* cannot be read to require the disclosure of any fair value cushion between 10% and 20%, and Plaintiffs do not contend otherwise. Moreover, as explained above, neither the SEC nor GAAP instructs companies to disclose fair value cushions below any specific threshold. Indeed, PwC advised Kraft Heinz that the only "close call judgments" were whether to disclose the brands and reporting units whose fair value cushions were less than 10%, and Kraft Heinz disclosed every one of them. (Ex. 24 at KHC_PFRS_00001912.)

Nevertheless, Plaintiffs point out that Garlati's August 1 presentation informed the Audit Committee that the U.S. Refrigerated reporting unit, the Kraft brand, and the Oscar Mayer brand had fair value cushions of 12%, 13%, and 13%, respectively. (CAC ¶ 8.) Plaintiffs do not allege that *this* information, standing alone, was MNPI that needed to be disclosed; instead, they allege that "[i]f the impairment testing had used current and realistic projections and other inputs *as of August 1, 2018*, the fair value cushions, if any, would have been even lower, and the Company would have had to make additional early warning disclosures as to" those three units and brands. (*Id.* (emphasis added).)

This fraud-by-hindsight allegation is entirely vague and merely "underscores the post-hoc nature of [Plaintiffs'] arguments." *Oracle*, 867 A.2d at 944. In no event does it suggest that 3G traded while in possession of MNPI. As already discussed, the market knew that Kraft Heinz's impairment analysis was based on projections and inputs that were "current" as of April 1, not August 1, and the market also knew that management had since revised some of those projections to be more conservative. Furthermore, Plaintiffs do not even allege—and certainly have provided no basis to conclude—that 3G knew what the results would have been had Kraft Heinz conducted a second impairment analysis based on unspecified "current and realistic projections and other inputs as of August 1." (CAC ¶ 8.) As discussed above, that is fatal under *Brophy*. *See, e.g.*, *Oracle*, 867 A.2d at 907-08.

4. The Compensation Committee's revised bonus formula does not support Plaintiffs' MNPI allegations.

Plaintiffs make much of the fact that, in June 2018, the Compensation Committee revised the formula Kraft Heinz used to calculate performance-based bonuses for high-ranking executives. (CAC ¶¶ 137, 162; *see* Ex. 40 at 3G_041-42.) The revised formula listed five Company performance metrics, including "U.S. NSV" (*i.e.*, net sales volume) and "U.S. Segment Adjusted EBITDA," and it specified a "Threshold" and "Target" amount for each one. (Ex. 40 at 3G_042.) Bonuses would depend in part on Kraft Heinz's performance relative to the threshold and target amounts. (*Id.*) Plaintiffs argue that this revised formula "call[s] into question the projections and inputs used for impairment testing," because (according to Plaintiffs) the revised performance metrics suggest "that KHC did not think that even the 2H18 Plan was reliable." (CAC ¶ 137; *see also* CAC ¶ 162.) As discussed earlier, the "2H18 Plan" refers to management's decision to lower its internal projections after the end of the first quarter of 2018. (CAC ¶ 136; Ex. 35 at KHC_PFRS_00004024.)

This argument makes little sense, because the Compensation Committee's recalibration of the bonus formula had nothing to do with the impairment analysis overseen by the Audit Committee; the two endeavors were run by different committees, who utilized different models, and were pursuing different goals. (*Compare* Ex. 41 at 3G_001, *with* Ex. 42 at 3G_001.) The Compensation Committee's judgment about how best to incentivize performance bears no relation to the mechanics or integrity of the impairment analysis.

Plaintiffs' argument is equally unpersuasive on its own terms, because there is no inconsistency between the revised bonus formula and the 2H18 Plan. The 2H18 Plan projected that 2018 U.S. Segment Adjusted EBITDA would be $5.78 billion. (Ex. 35 at KHC_PFRS_00004024.) Compare that to the bonus formula, which set a "Threshold" and "Target" amount for U.S. Segment Adjusted EBITDA at -6.4% and -3.0%, respectively. (Ex. 40 at 3G_042.) In 2017, U.S. Segment Adjusted EBITDA was $6.00 billion. (Ex. 11 at 3G_032, 33.) Thus, the revised bonus formula set a threshold and target for U.S. Segment Adjusted EBITDA at $5.62 billion and $5.82 billion. That range is consistent with the 2H18 Plan's projected 2018 U.S. Segment Adjusted EBITDA of $5.78 billion.[3] Contrary to Plaintiffs' argument, the revised bonus formula provides no reason whatsoever "to believe that KHC did not think that . . . the 2H18 Plan was reliable." (CAC ¶ 137.)

[3] The same point holds for U.S. NSV, where the revised bonus formula set a threshold at 99.1%, and a target at 100.2%, of the year before. (Ex. 40 at 3G_042.) Consistent with that—and as Plaintiffs acknowledge—the 2H18 Plan "forecast flat NSV for 2018." (CAC ¶ 160; Ex. 30 at KHC_PFRS_00001280.)

In all events, nothing about this argument suggests that 3G possessed MNPI at the time of its stock sale. If the revised bonus formula has any relevance at all to Plaintiffs' *Brophy* claim, it does no more than indicate that management had lowered its expectations for 2018 EBITDA at some point between the first and second quarters of 2018. But as discussed at length above, the market was fully aware of that fact before 3G sold any stock. Like Plaintiffs' attempts to criticize other aspects of the impairment analysis, this digression about the Compensation Committee's bonus formula does not move the *Brophy* needle one bit.

* * *

The foregoing makes clear that Kraft Heinz was transparent about the nature of the impairment analysis it conducted as of April 1, 2018. Plaintiffs' core allegation—that 3G knew about deep flaws with the analysis that were supposedly concealed from the market and that prefigured an impairment six months in the future—collapses because there is no material daylight between what 3G knew, and what the market knew, about Kraft Heinz's impairment analysis at the time of the sale. In the end, Plaintiffs have only criticized that analysis based on litigation-inspired hindsight, but they have done nothing to show that 3G had a material informational advantage at the time it sold stock.

B. The Complaint Fails To Allege That 3G Possessed MNPI About Kraft Heinz's Failure To Meet Management's Expectations.

The Complaint alleges that 3G possessed MNPI because 3G knew that Kraft Heinz had missed internal projections since 2017. (CAC ¶ 175.) This fact had been known to the market for that entire time.

Knopf told the market on August 3—four days before 3G's sale—that management no longer expected Kraft Heinz to meet the internal 2018 EBITDA projections it had set earlier in the year. As Knopf repeated three times, management now believed it was "appropriate to be more conservative in the near term with expectations around adjusted EBITDA. And instead of the second half skew that we previously talked about"—*i.e.*, instead of management's previous hope that a strong second half would offset sluggish first-half EBITDA—"we now expect more of a 50-50 split to the year." (Ex. 33 at 3G_007; *see also id.* at 3G_011, 13.) In terms of "Q3 prospects," Knopf told the market that management's formerly bullish view no longer held, and that "Q3 adjusted EBITDA dollars are likely to be down a greater order of magnitude than what we saw in the first half of the year," when EBITDA was already down 3.6%. (*Id.* at 3G_007; Ex. 32 at 3G_042.) As discussed previously, analysts correctly understood Knopf's comments "to mean that you're lowering your full-year EBITDA guidance by about $300 million" compared to the guidance management had given the previous quarter. (Ex. 33 at 3G_013.)

Plaintiffs ignore these public disclosures. Instead, they quote other remarks out of context to suggest that Kraft Heinz gave investors a picture of unbridled optimism at odds with management's representations to the Board. For example, Plaintiffs quote Knopf on the August 3 earnings call as saying "our first half financial performance was consistent with the type of start of the year we expected," omitting that he was talking specifically about "the profit line," and overlooking that this comment was consistent with what he and Hees told the Board. (CAC ¶¶ 11, 166; Ex. 33 at 3G_007; Ex. 31 at KHC_PFRS_00001301-02.) Plaintiffs also highlight several positive, more generalized comments from the earnings call expressing management's confidence in their "knowledge of the things that do work," their belief "that we have strong brands" and "a strong innovation pipeline," and the like. (CAC ¶¶ 165-66). None of those high-level comments was false, and none detracts from management's more specific—and, for purposes of this litigation, more relevant—concession that 2018 would be a disappointment relative to initial expectations.

Those disclosures followed management's concession that 2017 had been a disappointment as well, which Plaintiffs also ignore. But as recounted above, Hees told the market in February 2018 that "there is no question our financial results in 2017 did not meet our potential. Did we deliver profitable sales and grow our bottom line? Yes. Did it deliver to our potential? No. We had a slow start, some missteps along the way." (Ex. 12 at 3G_004.) He then detailed "4 key areas that held back our 2017 operation results," including "Q4 EBITDA in the United States." (*Id.* at 3G_004-05.)

Knopf elaborated on the disappointments, listing EBITDA, pricing in the United States, retail sales in Canada, and growth in Rest of World markets as areas where Kraft Heinz had failed to meet expectations. (*Id.* at 3G_006.) Addressing EBITDA specifically, Knopf noted a host of adverse circumstances that caught management by surprise, including the need to make "accelerated investments," "higher-than-expected freight costs," "unanticipated cost increases," "key commodity headwinds," and "higher onetime distribution costs." (*Id.*) Basilio added that unanticipated "trade spend" and "commodity cost" also drove down performance "versus our expectations." (*Id.* at 3G_010.) "As we said at the outset," Knopf concluded, "our 2017 financials do not reflect our potential." (*Id.* at 3G_006.)

Management discussed similar disappointments throughout 2017. Hees conceded in November 2017 that "we're not entirely satisfied with our financials," and Knopf reiterated that "our numbers have not been as strong as they could have been." (Ex. 8 at 3G_004, 08.) Earlier in the year, Zoghbi and Hees admitted that 2017 was off to a "slow start . . . with greater-than-expected declines in January and February," that "U.S. consumption was softer than expected," and that "the overall consumer takeaway" was "weaker than anticipated." (Ex. 3 at 3G_004-05.)

Analysts were likewise reporting that Kraft Heinz's earnings "fell short of expectations," that "[o]rganic growth fell well short of expectations," that "KHC failed to generate EBITDA growth for the first time as a combined public entity," and that Kraft Heinz suffered an "EBITDA shortfall vs. Consensus." (Ex. 4 at 3G_003; Ex. 7 at 3G_001.)

In the face of all that public disclosure and understanding, it is not reasonably conceivable that 3G possessed MNPI because it knew that Kraft Heinz had underperformed expectations since 2017. The most Plaintiffs can say is that the market did not know the precise gap between Kraft Heinz's results for previous quarters and the internal projections management had set at the start of those quarters. But the Complaint does not—and cannot—allege that such additional detail would have been material. To be material under *Brophy*, "nonpublic information must be of a magnitude that it would, upon disclosure, have 'significantly altered the total mix of information in the marketplace.'" *Oracle*, 867 A.2d at 934. "[I]nternal projections," however, "constantly change as the quarter progresses. That information is inherently transitory and fragmentary." *Id.* at 935. In all but the rarest cases, non-public information is immaterial under *Brophy* even if it indicates a gap between a company's *current* quarterly results and its *public* projections for that quarter. *Id.* at 939-41. It follows *a fortiori* that the non-public information at issue here—which at most concerned gaps between Kraft Heinz's *past* quarterly results and its *non-public* projections for those *past* quarters—is likewise immaterial.

C. The Complaint Fails To Allege That 3G Possessed MNPI About Internal Projected Cost Savings.

Plaintiffs next allege that 3G possessed MNPI because it knew that Kraft Heinz "would not achieve" management's internal "cost-cutting projections going forward." (CAC ¶ 175.) Here too, the market was well aware of the risk that management's unpublished cost-saving goals were unattainable.

Knopf repeatedly told the market during the August 3, 2018 earnings call that unanticipated levels of "cost inflation" would likely prevent Kraft Heinz from meeting management's projected cost savings. Three separate times during the call, Knopf explained that "we're seeing additional cost inflation that in the immediate term is outpacing the savings curve." (Ex. 33 at 3G_014; *id.* at 3G_007, 11.) Knopf made similar comments during the previous earnings call, when he disclosed that "inflation coming into this year" and "accelerated investments that we're making" were likely to "run ahead of our savings curve." (Ex. 19 at 3G_011.)

Again, Plaintiffs ignore those statements. Instead they fixate on an allegation that 3G knew that "[e]xpenses had increased in July 2018" versus June 2018. (CAC ¶ 12; *see also* CAC ¶¶ 159, 9, 10, 149, 167.) But that alleged detail is not material in light of Knopf's repeated emphasis on "additional cost inflation." Moreover, Plaintiffs do not allege that this detail about July vs. June spending was communicated to the Board or Audit Committee before 3G's stock sale; Plaintiffs' only supposed evidence for it is an Excel spreadsheet from 2019, months later. (Ex. 38 at KHC_PFRS_00003052.)

More broadly, the market had long known that Kraft Heinz's cost savings goals might prove unattainable. In 2017, analysts pressed management on whether its "approach to reducing costs may cut into multiple[s]," whether it was sustainable, and whether "the cost savings are close to full and fully identified." (Ex. 3 at 3G_009-10, 11.) Likewise, as Plaintiffs note (CAC ¶ 90), in February 2017 the *Wall Street Journal* asked whether Kraft Heinz was "running out of costs to cut." Chaudhuri & Gasparro, *supra*. And as Plaintiffs recount, in April 2017 Unilever publicly criticized Kraft Heinz for pursuing "deep cost reductions" that were "unsustainable in the long-term." (CAC ¶ 91.) In short, there is nothing non-public about this alleged class of MNPI.

Nor is there anything material about this alleged class of MNPI. Even when a company makes *public* projections, nonpublic information casting doubt on the company's ability meet those projections is not material under *Brophy* unless that information "created a *substantial* likelihood that [the company] would *markedly* depart" from its public projections. *Oracle*, 867 A.2d at 941 (emphasis added). Here, Kraft Heinz's cost-savings projections were private, not public, and even then, the Complaint does not allege that 3G possessed any information creating a substantial likelihood that Kraft Heinz would "underperform its projections in some *markedly unexpected manner*." *Id.* at 940 (emphasis added). Even if 3G had information casting doubt on Kraft Heinz's ability to meet its internal forecasts, such information is immaterial as a matter of law. *Id.*

D. The Complaint Fails To Allege That 3G Possessed MNPI About Walmart And Canadian Retailers.

Plaintiffs further allege that 3G possessed MNPI because it knew that Kraft Heinz's "largest customer, Walmart, had been 'accelerating' . . . its own private label offerings, erod[ing] KHC's market share, and exert[ing] 'unprecedented' pricing pressure." (CAC ¶ 175.) Yet again, there was nothing non-public about this information.

Kraft Heinz had long disclosed the "[c]oncentration of risk" arising from the fact that Walmart was its "largest customer," representing 20% or more of net sales every year since the merger. (Ex. 11 at 3G_102.) Four days before the stock sale, analysts asked Hees pointed questions about "Walmart taking as much volume share as they are," which Hees did not deny. (Ex. 33 at 3G_014.) Similarly, on the previous earnings call, analysts observed that Kraft Heinz's "brands have been wobbling in terms of their market share lately," and that "private label has been the beneficiary," which management again did not deny. (Ex. 19 at 3G_009.) Analysts asked similar questions throughout 2017. In November 2017, for instance, an analyst observed that "private brands are growing, that the good retailers there, Wegmans, Costco, H-E-B, are the ones that tend to have very, more developed private label programs and that others may want to catch up." (Ex. 8 at 3G_013.) Zoghbi confirmed the growing threat, responding, "[y]ou are right. This year, we have seen, after a long period of being flat, a renewed focus on . . . private label and some push on promoting private label as well." (*Id.* at 3G_013-14.) Zoghbi made the same point the previous quarter, confirming that there had been "a more pronounced focus in leading national retailers on increased private label" competition, and that this stepped-up competition was making "inroads." (Ex. 5 at 3G_014.)

The Complaint does not quite ignore these disclosures, but it does distort them. Plaintiffs claim that "management told analysts that Walmart's private-label market-share grab" was one of several "'transitory headwinds' or 'one-off' occurrences that would 'fade.'" (CAC ¶ 155; *see also* CAC ¶ 248.) Plaintiffs are misreading the transcript. The "transitory headwinds" that management expected to "fade" had nothing to do with Walmart; instead, they referred to specific difficulties with the "Planters and Ore-Ida" brands, which management had been discussing since the fourth quarter 2017 earnings call. (Ex. 33 at 3G_004, 12; Ex. 19 at 3G_004, 07, 13; Ex. 12 at 3G_010.) Likewise, the "one-off" factors Knopf and Hees mentioned were "lower sales of canned seafood in Indonesia and the truckers' strike in Brazil," and "fish supply in Indonesia and some inventory timing in China," which again had nothing to do with Walmart. (Ex. 33 at 3G_007, 15.)

Plaintiffs also emphasize a slide in Hees's August 2, 2018 Board presentation (CAC ¶ 156), which contained a chart showing that Walmart was generally accelerating its capture of U.S. Food & Beverage Industry sales. (Ex. 29 at KHC_PFRS_00001262.) None of that information was MNPI. In fact, the slide disclosed that the "Source" of the chart's data was The Nielsen Company (*id.*), an independent data analytics company that collects and sells grocery sales data that analysts, investors, and companies rely upon. The "accelerating" nature of Walmart's growth was thus known to the market—as suggested by the pointed analysts' questions discussed above.[4]

Finally, Plaintiffs allege that 3G possessed MNPI about "the lingering fallout" from 2017 contract renegotiations between Kraft Heinz and two Canadian retailers. (CAC ¶ 12.) This allegation fails because Basilio told the market at the beginning of 2017 that Kraft Heinz suffered losses "in the Canadian retail market" as a result

[4] The Nielsen Company publicly released a report in February 2018, which presented a wealth of market data illustrating "the development of private-label products and the new challenges that this will present for brands and manufacturers across the globe." The Nielsen Company (US), LLC, *The Rise and Rise Again of Private Label* 2 (2018), https://bit.ly/2xyXJXo.

of these contract renegotiations (Ex. 3 at 3G_004, 06, 10-11); and in February, Knopf told the market that those losses "look[] to be permanent, so this will likely translate into some headwinds moving forward." (Ex. 12 at 3G_006.) In addition, Plaintiffs confirm that 3G did not know any more than the market did about the impairment risk created by Kraft Heinz's Canadian retail operations, because the second quarter 2018 10-Q disclosed that the Canada Retail reporting unit had a fair value cushion of less than 10% (Ex. 32 at 3G_015), and the Complaint concedes that "[n]either management nor the Audit Committee . . . perform[ed] any further analysis or [ran] any sensitivities on the . . . Canadian reporting units." (CAC ¶ 134; *see also* CAC ¶¶ 131, 135.)

E. The Complaint Fails To Allege That 3G Possessed MNPI About Kraft Heinz's Receipt Of A Document Preservation Request.

Plaintiffs allege that 3G possessed MNPI because it knew that, almost a month before the sale, the SEC sent Kraft Heinz a document preservation request related to its procurement function. (CAC ¶¶ 12, 175.) This allegation fails because nobody from 3G was present when Kraft Heinz's General Counsel disclosed this information to the Audit Committee on August 1. (*See* Ex. 28.) Plaintiffs ask the Court "to infer that [the General Counsel] had informed Hees" because "she reported to him" (CAC ¶ 140), but this Court has repeatedly held that it will not assume that an officer or director had knowledge of MNPI solely by virtue of his or her position, which is what Plaintiffs are asking for here. *Tilden v. Cunningham*, 2018 WL 5307706, at *19 (Del. Ch. Oct. 26, 2018); *Rattner v. Bidzo*s, 2003 WL 22284323, at *10-11 (Del. Ch. Sept. 30, 2003); *Guttman v. Huang*, 823 A.2d 492, 503-05 (Del. Ch. 2003).

In all events, this alleged information was not material. It concerned only a request to preserve documents, not a subpoena, and its consequences were negligible. A subsequent investigation led Kraft Heinz to restate its "cost of products sold" from 2015 to 2018 by $208 million out of $63.7 billion—a change of less than 0.33%. (*See* CAC ¶ 227; Ex. 39 at 3G_003; Ex. 36 at 3G_012; Ex. 11 at 3G_054.) None of these adjustments was material in any quarter. (Ex. 39 at 3G_003.) Information of this sort plainly would not have "significantly altered the 'total mix' of information in the marketplace." *Oracle*, 867 A.2d at 934; *In re Lions Gate Entm't Corp. Sec. Litig.*, 165 F. Supp. 3d 1, 13 (S.D.N.Y. 2016) (holding that plaintiffs "failed to allege that [an SEC] investigation itself was material" in part because "[t]he $7.5 million civil penalty was less than one percent of [the Company's] consolidated revenue of $839.9 million"); *Mandalevy v. Bofi Holding, Inc.*, 2018 WL 6436723, at *7 (S.D. Cal. Dec. 7, 2018) ("Not all investigations are material.").

F. **The Complaint Fails To Allege That 3G, As An Entity, Had Knowledge Of MNPI.**

Plaintiffs' MNPI allegations all fail for the independent reason that the Complaint does not create a reasonable inference that 3G, as an entity, possessed MNPI when it sold stock. To establish 3G's "knowledge," Plaintiffs must rely on agency principles. Under Delaware law, "courts will impute the knowledge of corporate actors to its corporate employer 'when the agent was acting within the scope of his authority.'" *EMSI Acquisition, Inc. v. Contrarian Funds, LLC*, 2017 WL 1732369, at *13 (Del. Ch. May 3, 2017). Here, Plaintiffs allege that 3G "had access to" MNPI because MNPI was allegedly known to 3G partners who served as Kraft Heinz officers or directors. (CAC ¶ 176.) But as Plaintiffs admit, those individuals learned MNPI, if at all, only "in their capacities as KHC directors" and officers, not in their capacity as agents of 3G. (CAC ¶ 176(a).) That means their knowledge cannot be mechanically imputed to 3G. *See* RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. c (2006); 3 William Meade Fletcher, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 789 (2019).

Some non-*Brophy* cases have held that if a director breaches a fiduciary duty to his corporation, his "knowledge" concerning the breach "may be imputed" to a third-party entity "for which that director also serves in a fiduciary capacity," so as to render that entity liable for aiding and abetting the director's breach. *Ogus v.*

SportTechie, Inc., 2020 WL 502996, at *11 (Del. Ch. Jan. 31, 2020). Whatever its merits elsewhere, this rule is inappropriate under *Brophy*, which "is not designed to punish inadvertence, but to police intentional misconduct." *Guttman*, 823 A.2d at 505. In all events, even if that rule were applied here, it would do Plaintiffs little good, because the vast majority of alleged MNPI concerning the 2018 annual impairment assessment was never shared with Kraft Heinz's full Board, but only with the Audit Committee, and 3G had no affiliated directors on that Committee. The only 3G affiliate present at those meetings was Knopf, Kraft Heinz's CFO. But cases that impute knowledge from a director to a third-party entity should not be extended to impute knowledge from an *officer* to a third-party entity, because officers indisputably carry out their functions as agents and fiduciaries of the corporation that employs them, and not as agents or fiduciaries of third-party entities with which they might also be affiliated. *See, e.g.*, 18B AM. JUR. 2D CORPORATIONS § 1425 (2015) ("Generally, the fact that two or more corporations have officers or agents in common will not of itself impute the knowledge gained by such officers while acting for one corporation to another corporation in which they also hold office.").

Moreover, unlike in other *Brophy* cases involving trades by entities, this Complaint includes no well-pled allegation that 3G's affiliates at Kraft Heinz shared MNPI with the specific individuals at 3G who were responsible for the stock sale.

See Kahn, 23 A.3d at 834 ("Primedia's KKR directors authored an advisory memo to KKR's Investment Committee and Portfolio Committee . . . advocating the purchase of Primedia's preferred shares," which "contained nonpublic information about Primedia."). Further, unlike other *Brophy* cases involving entity defendants, Plaintiffs here do not—and cannot—allege that 3G sold any shares on behalf of its partners who were Kraft Heinz officers or directors. *See Tilden*, 2018 WL 5307706, at *7; *In re Fitbit, Inc. Stockholder Derivative Litig.*, 2018 WL 6587159, at *14 (Del. Ch. Dec. 14, 2018). These deficiencies foreclose Plaintiffs from properly alleging 3G's knowledge.

II. THE COMPLAINT FAILS TO ALLEGE SCIENTER.

In addition to the defects discussed above, Plaintiffs' *Brophy* claim must be dismissed for the independent reason that the Complaint "fail[s] to plead facts to support a reasonable inference that '[3G's sale] was entered into and completed *on the basis of, and because of,* adverse material non-public information.'" *Tilden*, 2018 WL 5307706, at *20 (emphasis in original). As this Court has explained, "[a]t the pleading stage, . . . a successful [*Brophy*] claim typically includes allegations" that the defendant's trade was "unusually large . . . relative to the defendant's overall stock holdings," or that it was "suspiciously timed." *Clovis*, 2019 WL 4850188, at *15. This Complaint cannot allege either of those circumstances. In fact, the size, timing, and other features of 3G's stock sale defeat any inference of scienter.

First, 3G "sold only 7% of [its] position, leaving [it] a huge stake in the company." *Oracle*, 867 A.2d at 954. That percentage is far too small to support an inference of scienter. *Oracle* rejected an inference of scienter where the defendant sold this same amount—7%—of his stake. *Id.* That holding is dwarfed by other cases. This Court has dismissed *Brophy* claims for failure to plead scienter where the defendant sold 10% of his stock, *Clovis*, 2019 WL 4850188, at *16; where the defendants sold 10%, 20%, and 32% of their stock, *Guttman*, 823 A.2d at 504; and where the defendant sold 37% of his stock, *see Tilden*, 2018 WL 5307706, at *20; *see* Verified Derivative First Amended Complaint at ¶ 68, *Tilden*, 2018 WL 5307706 (No. 2017-0837), 2017 WL 5956724 (Trans. ID 61393571). Under that long line of precedent, there is no question that 3G's sale was "so small in relation to [its Kraft Heinz] stock holdings as to defy any inference of the bad intent required to state a claim." *Clovis*, 2019 WL 4850188, at *1.

Second, nothing about the timing of 3G's stock sale creates an inference of scienter. 3G's sale took place two business days after Kraft Heinz released its second quarter 10-Q, and this Court has held many times that "[n]o inference can be drawn from that simple fact because it is more obviously consistent with the idea that [Kraft Heinz] permitted stock sales in such periods because it diminished the possibility that insiders could exploit outside market buyers." *Guttman*, 823 A.2d at 503-04; *Rattner*, 2003 WL 22284323, at *10, 12; *Tilden*, 2018 WL 5307706, at *20; *Clovis*, 2019 WL 4850188, at *15-16. And in fact Kraft Heinz's insider trading policy imposed a blackout period that barred trading from the second-to-last Friday of each quarter until "[i]mmediately following the completion of one full trading day after Kraft Heinz issues its earnings release." (Ex. 18 at KHC_PFRS_00003398.) In addition, 3G sold another modest portion of its stake early in the third quarter of 2016, also on behalf of Limited Partner investors, which further dispels any suspicions about the timing of the sale. (Ex. 2 at 3G_002 n.3; CAC ¶ 170.) Plaintiffs emphasize that 3G did not sell Kraft Heinz stock in the twelve months before the 2018 sale (CAC ¶ 170), but "[t]he prior year measure in itself is a weak one, covering as it does a temporally brief period." *Guttman*, 823 A.2d at 504.

The Court's scienter analysis can stop there. But the above considerations are even more compelling in light of 3G's representation to the SEC—which Plaintiffs never challenge—that the August 2018 stock sale "did not include any Shares related to the original interest of the partners of 3G Capital Partners in . . . The Kraft Heinz Company." (Ex. 34 at 3G_002 n.3 (cited in CAC ¶ 177).) 3G's partners who were Kraft Heinz officers or directors have not been accused of any unlawful trades, or of profiting—directly or indirectly—from the sale.

Given all of these considerations, "it is difficult," if not impossible, "reasonably to infer [that 3G] was 'fleeing disaster or seeking to make an unfair buck'" when it sold just 7% of its Kraft Heinz holdings in August 2018, days after the company had issued disappointing results and meaningful warnings. *Clovis*, 2019 WL 4850188, at *15 (quoting *Oracle*, 867 A.2d at 954). 3G retained a massive amount of exposure immediately following the sale, owning more than 270 million Kraft Heinz shares worth over $16 billion. (*See* Ex. 34.) "In other words, in large measure, notwithstanding [its] alleged knowledge of the corporate trauma soon to come, [3G] rode over the falls with the rest of [Kraft Heinz's] stockholders when the corporate storm hit the Company." *Clovis*, 2019 WL 4850188, at *16. Under a long line of settled precedent, Plaintiffs' scienter allegations are plainly inadequate to state a claim.

III. THE COMPLAINT FAILS TO ALLEGE THAT 3G IS A CORPORATE FIDUCIARY.

Brophy claims lie only against corporate fiduciaries. *Kahn*, 23 A.3d at 838. Plaintiffs allege that 3G is a Kraft Heinz fiduciary "[b]y virtue of" being a "controlling stockholder[]." (CAC ¶ 239.) This theory fails because 3G has always been a minority stockholder of Kraft Heinz, with three of eleven Board seats and a less-than-25% stake that was always outweighed by Berkshire Hathaway's nearly 27% stake. (CAC ¶¶ 72-73, 79.) This Court has held that alleging control as to minority stockholders is extremely difficult: "the operative question" is whether 3G "*controlled the [Kraft Heinz] board* . . . such that the directors of [Kraft Heinz] could not freely exercise their judgment." *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 993 (Del. Ch. 2014) (emphasis in original). The allegations here do not come close to alleging that 3G's "power is so potent that independent directors and minority stockholders cannot freely exercise their judgment, fearing retribution from [3G]." *Id.* at 992. Nor is 3G part of a "control group." (KHC Mot. 29 n.12.)

Moreover, although Plaintiffs repeatedly refer to "3G" when describing Kraft Heinz management, that is a rhetorical strategy, not a legal argument. It misses "the operative question under Delaware law," which is not whether 3G "managed the day-to-day operations" of Kraft Heinz, but instead whether 3G "controlled the board" of Kraft Heinz. *KKR*, 101 A.3d at 993. In all events, with respect to the Kraft Heinz officers who managed the Company's day-to-day affairs, the Complaint nowhere alleges that any "person or entity"—including 3G—"had a *right* to direct their actions," which precludes a finding that 3G is a controller and thus a fiduciary. *Skye Mineral Inv'rs, LLC v. DXS Capital (U.S.) Ltd.*, 2020 WL 881544, at *28 (Del. Ch. Feb. 24, 2020) (emphasis in original).

IV. COUNTS II AND III MUST BE DISMISSED.

Count II of the Complaint seeks contribution and indemnification against 3G for "causing" Kraft Heinz to violate federal securities laws, as alleged in a lawsuit currently pending in federal court. (CAC ¶ 253.) This count must be dismissed as unripe. (*See* KHC Mot. 48-49.) It must also be dismissed as to 3G because—as just discussed—3G is not a controlling stockholder, and thus did not "cause" any of Kraft Heinz's allegedly unlawful conduct.

Count III alleges that 3G is liable for aiding and abetting various individuals' *Brophy* violations. (CAC ¶¶ 254-57.) This count must be dismissed because Plaintiffs have failed to state an underlying *Brophy* claim. *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 72 (Del. 1995).

CONCLUSION

3G's motion to dismiss should be granted with prejudice.

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