United States Court of Appeals
For the Eighth Circuit

No. 20-3216

Carpenters' Pension Fund of Illinois; Iron Workers Pension Fund, Local 11; Peoria Police Pension Fund; Laura Wood; Harkishan Parekh, derivatively on behalf of Centene Corporation

Plaintiffs - Appellants

v.

Michael Neidorff; Jeffrey A. Schwaneke; Robert K. Ditmore; David Steward; John R. Roberts; Tommy G. Thompson; Frederick H. Eppinger; Richard Gephardt; Orlando Ayala; Vicki B. Escarra; K. Rone Baldwin; Carol E. Goldman; Centene Corporation, a Delaware corporation

Defendants - Appellees

Appeal from United States District Court
for the Eastern District of Missouri - St. Louis

Submitted: September 23, 2021
Filed: April 7, 2022

Before SHEPHERD, WOLLMAN, and KOBES, Circuit Judges.

SHEPHERD, Circuit Judge.

Following the merger of Centene Corporation (Centene) and Health Net, Inc. (Health Net), certain shareholders of Centene (collectively, Appellants) brought five

claims on behalf of the corporation against certain of its former and then-current directors and officers and nominal defendant Centene (collectively, Appellees): (1) violation of § 14(a) of the Securities Exchange Act of 1934; (2) breach of fiduciary duties of good faith, fair dealing, loyalty, and due care; (3) breach of fiduciary duty of loyalty, good faith, and candor in connection with securities law violations; (4) insider trading; and (5) unjust enrichment. Appellants did not make pre-suit demand on Centene's Board of Directors (the Board) and the district court[1] dismissed their complaint with prejudice, finding that Appellants had failed to plead particularized facts demonstrating that demand would have been futile. Appellants appeal the district court's dismissal, and having jurisdiction under 28 U.S.C. § 1291, we affirm.

I.

Centene is a Delaware corporation that sells health insurance policies for Medicaid, Medicare Advantage, and Medi-Cal, among other products. Prior to its merger with Centene, Health Net sold health insurance policies to individuals, families, and businesses; offered behavioral health, substance abuse, and employee assistance programs; and offered plans for the provision of prescription drugs. In November 2014, Centene's President and CEO, Michael F. Neidorff, contacted Health Net's CEO, Jay Gellert, to discuss their respective businesses. On June 8, 2015, Neidorff informed Gellert that Centene was interested in pursuing a potential business combination with Health Net. Throughout the remainder of June 2015, the Board met on several occasions to discuss the proposed transaction. On July 1, 2015, the Board unanimously approved a merger of the two companies, and the next day, Centene and Health Net put out a joint press release announcing the merger.

Centene and Health Net issued a joint proxy statement (the Proxy Statement) on September 21, 2015, asking for shareholder approval of the merger. The Proxy

[1]The Honorable Catherine D. Perry, United States District Judge for the Eastern District of Missouri.

Statement detailed the considerations made and rationale in pursuing the transaction, negotiations between the companies, and risk factors associated with the transaction. On October 23, 2015, Centene's shareholders voted to approve the merger, which ultimately closed on March 24, 2016, after regulatory approval. Appellants allege that at the time the Proxy Statement issued, and continuing through the closing date, Centene's directors and officers concealed their knowledge of Health Net's significant financial problems from shareholders, including that Health Net had poorly designed and unprofitable policies, was subject to liability based upon its refusal to pay claims from substance abuse treatment centers in California, and had significant potential tax liabilities.

On April 26, 2016, Centene filed a SEC Form 10-Q (the April 10-Q) reporting its first-quarter financial performance. There, Centene stated that due to the timing of the merger's closing, only preliminary estimates of Health Net's assets and liabilities as of the date of acquisition were available for reporting and such estimates were subject to change. The April 10-Q did not address any premium deficiency reserves (PDRs)[2] that may have been necessary to cover Health Net liabilities, even though Centene's audit committee had determined on April 25, 2016, the day before the form was filed, that the PDRs for Health Net needed to be set, at a minimum, to $117 million. Following the filing of the April 10-Q, Neidorff and other Centene officers assured the public of the merger's success on multiple occasions.

On July 26, 2016, Centene released its second-quarter financial results. These results disclosed a $390 million increase in reserves for Health Net's increased liabilities, including a $90 million increase in reserves for disputed claims arising from Health Net's dealings with substance abuse treatment centers and a $300 million PDR booked to account for potential losses related to underperforming contracts. Following this disclosure, Centene's stock price dropped more than 8%, amounting to a loss of over $1 billion in stockholder value. Neidorff later admitted

[2]"A premium deficiency reserve is an accounting tool that acknowledges that a firm's projected losses are greater than its projected premiums." United States v. Aetna Inc., 240 F. Supp. 3d 1, 87 (D.D.C. 2017).

that Centene knew of problems with Health Net's business and policies prior to the merger. Further, between the time the merger was approved by shareholders and the release of Centene's second-quarter financial results, several Centene directors and officers sold or disposed of nearly half-a-million shares of Centene stock worth more than $28 million in total.

After the district court consolidated Appellants' separate derivative actions, Appellants filed their Verified Consolidated Amended Stockholder Derivative Complaint (the Amended Complaint). Significantly, Appellants did not demand that the Board bring the desired lawsuit, instead arguing that demand would be futile because a majority of the Board could not have impartially considered whether to bring such suit. At the time Appellants filed the Amended Complaint, the Board consisted of nine directors: inside-director Neidorff and eight outside directors. Appellees include Neidorff and outside-directors Robert K. Ditmore, David L. Steward, John R. Roberts, Tommy G. Thompson, Frederick H. Eppinger, Richard A. Gephardt, and Orlando Ayala (collectively, the Director Defendants). Outside-director Jessica Blume, who was not a director when the Proxy Statement issued in September 2015, is not named as a defendant.

Appellees filed a motion to dismiss the Amended Complaint, arguing that Appellants failed to plead demand futility. The district court granted Appellees' motion and dismissed the case with prejudice, finding that Appellants failed to plead facts with sufficient particularity that would excuse pre-suit demand. Appellants timely brought the present appeal, arguing that the district court erred in finding that the Amended Complaint failed to demonstrate demand futility.

II.

We review a district court's grant of a motion to dismiss de novo, accepting all allegations within the complaint as true. Gomes v. Am. Century Cos., 710 F.3d 811, 815 (8th Cir. 2013). "To survive a motion to dismiss, a complaint must plead 'enough facts to state a claim to relief that is plausible on its face.'" Id. (quoting

Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007)). Federal Rule of Civil Procedure 23.1, however, subjects complaints in a derivative action to a heightened pleading standard, requiring that shareholders "state with particularity . . . any effort . . . to obtain the desired action from the directors or comparable authority" and "the reasons for not obtaining the action or not making the effort." Fed. R. Civ. P. 23.1(b)(3). This Court recognizes Rule 23.1 as "'a rule of pleading' that 'requires that the complaint in such a case allege the facts that will enable a federal court to decide whether such a demand requirement has been satisfied.'" Gomes, 710 F.3d at 815 (citation omitted). Thus, where shareholders do not make demand on the board, those shareholders must plead with particularity the reasons why such demand would have been futile and should therefore be excused.

Before reaching the merits of the issue, we must first determine the proper framework for assessing demand futility. Because Centene is a Delaware corporation, Delaware law applies. See Cottrell ex rel. Wal-Mart Stores v. Duke, 829 F.3d 983, 989 (8th Cir. 2016). For many years, Delaware courts applied one of two tests for demand futility, with the appropriate test dictated by the composition of the board upon which demand was to be made (the demand board). The first test, set forth in Aronson v. Lewis, applied where the complaint challenged a decision made by the demand board and required plaintiffs to plead particularized facts demonstrating a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." Rales v. Blasband, 634 A.2d 927, 933 (Del. 1993) (alteration in original) (quoting Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000)). Alternatively, the second test, set forth in Rales v. Blasband, applied "where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit." 634 A.2d at 933-34. The Rales test required the court to "determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its

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