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Transaction ID 65918293
Case No. 2020-0775-

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

JOHN SOLAK, derivatively on behalf of DENALI THERAPEUTICS, INC., Plaintiffs, VICKI L. SATO, Ph.D., RYAN J. WATTS, Ph.D., DOUGLAS G. COLE, M.D., JENNIFER COOK, JAY FLATLEY, PETER KLEIN, ROBERT T. NELSEN, DAVID P. SCHENKEIN, M.D. and MARC TESSIER-LAVIGNE, Ph.D., Defendants, -and- DENALI THERAPEUTICS, INC., a Delaware corporation, Nominal Defendant.	C.A. No. : ________________

VERIFIED SHAREHOLDER DERIVATIVE COMPLAINT FOR BREACH OF FIDUCIARY DUTY, UNJUST ENRICHMENT, AND WASTE OF CORPORATE ASSETS

Plaintiff, John Solak, by his attorneys, submits this Verified Shareholder Derivative Complaint in the name of, and on behalf of, nominal defendant Denali Therapeutics, Inc. ("Denali" or the "Company") against certain directors and officers of Denali for Breach of Fiduciary Duty, Unjust Enrichment, and Waste of Corporate Assets.

NATURE AND SUMMARY OF THE ACTION

1. Without shareholder approval, Denali's Board of Directors (the "Board") adopted a compensation plan which grossly overcompensates its members, in comparison to companies of similar market capitalization, industry, and size (*i.e.*, "peers"), by a factor of nearly three times.

2. Moreover, Denali's non-employee director compensation plan fails to take into account any relevant metrics, such as revenue and (lack of) profit, in setting compensation. In fact, despite the Company's substantial cumulative loss since going public, Denali's non-employee directors have consistently awarded themselves outsized compensation.

3. Plaintiff brings this action to recoup the excessive compensation taken by the Non-Employee Director Defendants (defined *infra*), and to force meaningful corporate governance reforms that will both restrict the Non-Employee Director Defendants' ability to award themselves egregious compensation, and align the elements of compensation, including grants of options to purchase the Company's stock, with the Company's success and long-term interests.

THE PARTIES

4. Plaintiff John Solak is, and at all times relevant hereto has been, an owner and holder of Denali Therapeutics common stock.

5. Nominal Defendant Denali is a Delaware corporation with its corporate headquarters located at 161 Oyster Point Boulevard, South San Francisco, CA 94080. Denali is a biotechnology company engaged in developing and discovering therapeutics to treat neurodegeneration disease. The Company was incorporated in Delaware on October 14, 2013, and it went public on December 8, 2017. Denali's shares presently trade on the NASDAQ Global Select Market under the symbol "DNLI."

6. Defendant Vicki L. Sato, Ph.D. ("Sato") has served as a member of the Board since April 2015 and is the current Chairperson of the Board.

7. Defendant Ryan J. Watts, Ph.D. ("Watts") has served as Denali's President and Chief Executive Officer since August 2015, and as a member of the Board since March 2015.

8. Defendant Douglas G. Cole, M.D. ("Cole") has served as a member of the Board since May 2015.

9. Defendant Jennifer Cook ("Cook") has served as a member of the Board since March 2018.

10. Defendant Jay T. Flatley ("Flatley") has served as a member of the Board since April 2015. Flatley is a member of the Compensation Committee.

11. Defendant Peter S. Klein ("Klein") has served as a member of the Board since June 2015.

12. Defendant Robert T. Nelsen ("Nelsen") has served as a member of the Board since May 2015. Nelsen is a member of the Compensation Committee.

13. Defendant David P. Schenkein, M.D., ("Schenkein") has served as a member of the Board since April 2015.

14. Defendant Marc Tessier-Lavigne, Ph.D., ("Tessier-Lavigne") has served as a member of the Board since March 2015. Tessier-Lavigne is the Chair of the Compensation Committee.

15. The defendants identified in paragraphs 6-14 are referred to collectively as the "Director Defendants."

16. The defendants identified in paragraphs 6, 8-14 are referred to collectively as the "Non-Employee Director Defendants."

THE NON-EMPLOYEE DIRECTOR DEFENDANTS ARE AWARDED EXCESSIVE COMPENSATION

17. Since going public in 2017, the median compensation received by Denali's Non-Employee Director Defendants has averaged $480,279 – an amount significantly exceeding, not only Denali's peers, but the average total director compensation for non-employee directors sitting on the board of a Top 200 Company, S&P 500 company, or a Fortune 500 company.[1]

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[1] Information obtained from director compensation studies and reports, issued for years 2017 through 2019, by FW Cook, NACD and Pearl Meyer, Stephen Hall & Partners, Spencer Stuart, Willis Tower Watson, and Institutional Shareholder Services (the "Director Compensation Studies") reveals that median compensation

18. Denali, however, is neither a Top 200 Company, S&P 500, nor a Fortune 500 company. Rather, with a current market capitalization of approximately $3.5 billion, Denali is considered a "midcap" company and, indeed, is a constituent of the Russell 2000 midcap index.

19. In relation to its midcap peers, the average of Denali's median total non-employee director compensation stands at a level nearly ***three times*** that of its peer companies.[2] As such, the Non-Employee Director Defendants' compensation is unwarranted and grossly excessive in comparison to other companies of similar size.

20. Denali's non-employee director compensation also stands at a level far greater than its pharmaceutical and biotechnology peers.

21. For example, in 2019, median total direct compensation of non-employee directors at similarly-sized pharmaceuticals, biotechnology and life sciences companies was approximately $335,000.[3]

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for non-employee directors at Top 200, S&P 500, and Fortune 500 companies ranges between $250,000 and $300,000.

[2] The Director Compensation Studies reveal that the median total annual compensation for non-employee directors of midcap companies ranges between $150,000 and $250,000.

[3] *See* Director Compensation Studies, generally, and, specifically, the NACD and Pearl Meyer 2018-2019 Director Compensation Report and the Institutional Shareholder Services, "Snapshot: Update on U.S. Director Pay," ISS Analytics, May 3, 2019.

22. In 2017, alone, the Non-Employee Director Defendants awarded themselves an astonishing median compensation of $632,857, and, in 2018 and 2019, the median compensation received was only slightly less appalling, standing at $404,653 and $403,326, respectively.

23. By way of comparison, non-employee directors for pharmaceutical giants Merck & Co., Inc. ("Merck") and Pfizer Inc. ("Pfizer") (which are both S&P 500 constituents) earned considerably *less* than the Director Defendants in 2019 receiving $330,252 and $367,822, respectively.

24. Unlike Denali, Merck has approximately 71,000 employees, operates in more than 140 countries and markets dozens of products.[4] In 2019, alone, Merck generated $46.8 billion in revenue and $9.8 billion in net income.

25. Similarly, Pfizer has approximately 88,300 employees, has 49 manufacturing sites, operates in more than 125 countries, and markets dozens of products.[5] In 2019, alone, Pfizer generated $51.8 billion in revenue and $16.3 billion in net income.

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4 Merck, https://www.merck.com (last accessed August 6, 2020).

5 Pfizer, https://www.pfizer.com (last accessed August 21, 2020).

26. By contrast, Denali has 276 employees and zero products that have reached the market.[6] In 2019, Denali generated $26.68 million in revenue and reported $197.97 million in negative net income.

27. Notwithstanding, in 2018 and 2019, the median compensation received by the Non-Employee Director Defendants stood at $404,653 and $403,326, respectively. Moreover, the average of median compensation received by the Non-Employee Director Defendants since going public in 2017 is $480,279, which is more than 30% greater than the median compensation awarded to non-employee directors at Merck and Pfizer in 2019.

28. In its annual proxy statements for 2017 and 2018, Denali makes reference to purported "peers" but fails to identify any peer companies used as comparators. In its 2019 Proxy, Denali does identify some twenty companies but the list is both self-serving and inherently suspect for various reasons, including the fact that it contains companies with a far greater market cap than Denali and that a vast majority of the companies identified, like Denali, used the services of the same compensation consultant: Radford. It stands to reason that Radford would tend to agree with itself when it comes to peer analysis.

[6] Denali, https://denalitherapeutics.com/pipeline (last accessed August 21, 2020).

29. Using a more objective analysis, like those reflected in the various director compensation studies relied on herein, illustrates just how stark the disparity is between the non-employee director pay of Denali and other mid-sized health, biotech, and pharmaceutical companies.

30. For example, the below table contains the average annual non-employee director compensation for a cross section of mid-sized health, biotech, and pharmaceutical companies identified by Steven Hall & Partners in its 2019 Director Compensation Study:

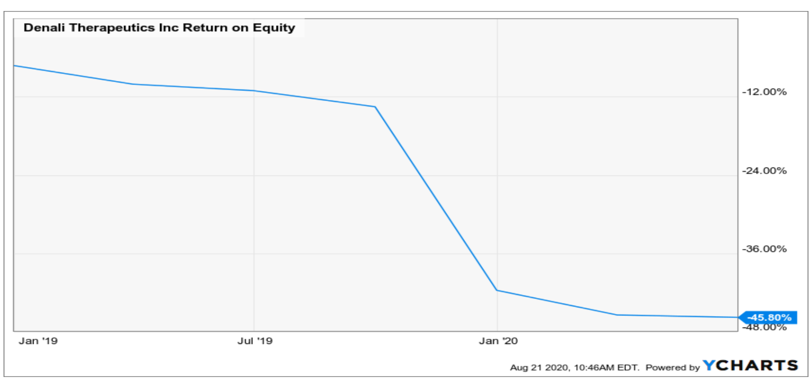
Company	Market Cap	Total Revenue	Avg. Comp.
Acadia Healthcare Co., Inc.	$ 2,751,000,000	$ 3,110,000,000	$ 288,433
Allscripts Healthcare Sol., Inc.	$ 1,419,000,000	$ 1,770,000,000	$ 273,146
Bio-Techne Corp	$ 10,288,900,000	$ 710,000,000	$ 217,292
Charles River Labs. Int'l	$ 10,585,000,000	$ 2,620,000,000	$ 305,105
Encompass Health Corp.	$ 6,715,000,000	$ 4,610,000,000	$ 251,575
Healthequity, Inc.	$ 3,960,000,000	$ 290,000,000	$ 212,813
Hill-Rom Holdings Inc.	$ 6,321,000,000	$ 2,910,000,000	$ 247,700
LivaNova Plc	$ 2,269,000,000	$ 1,080,000,000	$ 246,658
Masimo Corp	$ 12,289,000,000	$ 940,000,000	$ 269,762
MEDNAX Inc.	$ 1,728,000,000	$ 3,510,000,000	$ 111,043
NuVasive, Inc.	$ 2,728,000,000	$ 1,170,000,000	$ 239,432
Steris Plc	$ 13,437,000,000	$ 3,030,000,000	$ 318,484
Teleflex, Inc.	$ 17,308,000,000	$ 2,448,400,000	$ 281,154
West Pharmaceutical Servs	$ 20,243,000,000	$ 1,840,000,000	$ 290,931

31. Not one of the companies identified in the above table approaches the level of non-employee director compensation of Denali.

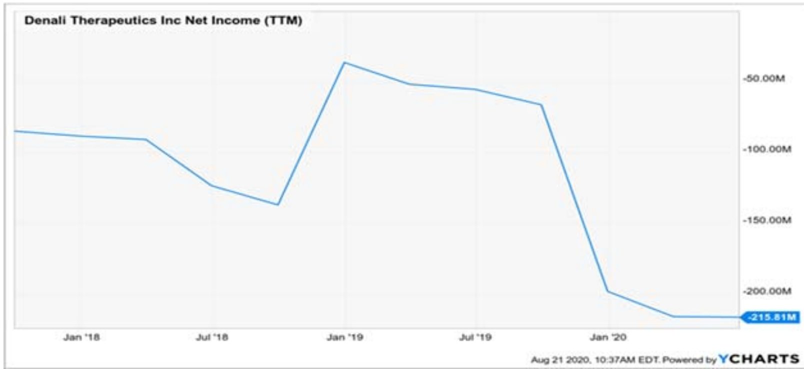
32. Had Denali's Board conducted a legitimate peer analysis, considering appropriate peers, as opposed to a self-validating Radford group of companies, it would have been abundantly clear that the level of Denali's non-employee director compensation is without justification.

33. Moreover, if the sheer level of Denali's non-employee director compensation is not shocking enough in its own regard, it certainly is when considered against the backdrop that the Company has recorded a loss attributable to common stockholders every year since going public in 2017, as the Company has increased its research and development expenditures which vastly outstrip its revenues, if any.

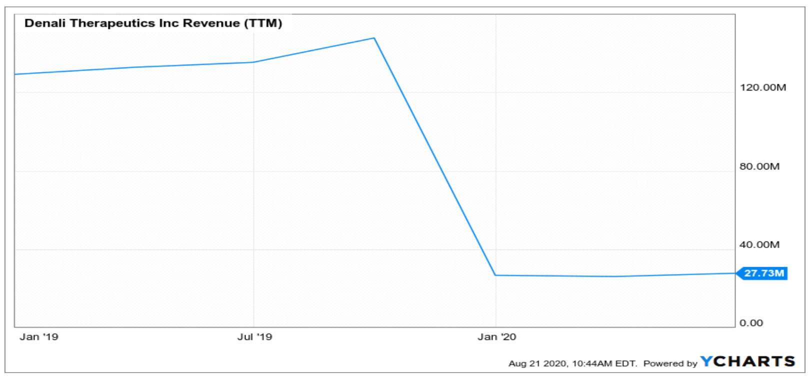
34. In fact, the Company's return on equity, net income, and revenue have all significantly *decreased* since it went public in 2017.



Return on Equity

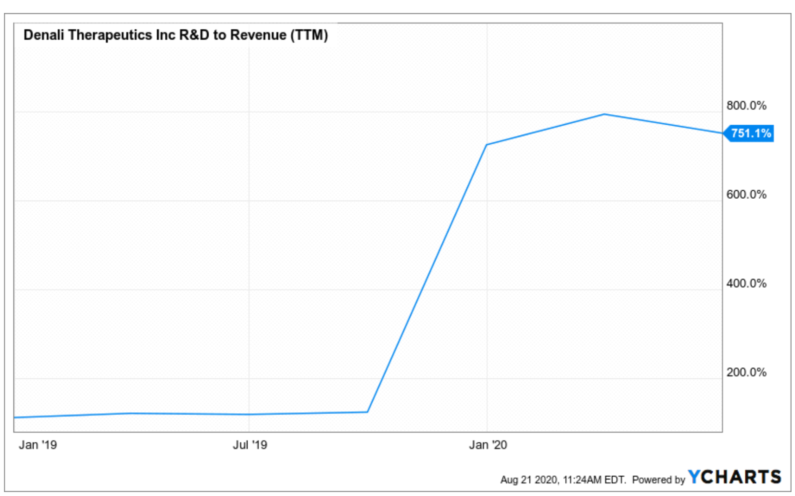


Net Income



Revenue (TTM)

35. Yet, despite incurring increasingly large investments without generating any additional revenue, the Board, rather than preserve the Company's precious resources, has resolved to award, and to continue to award, the Non-Employee Director Defendants grossly excessive levels of compensation.



R&D to Revenue (TTM)

36. Denali shareholders have never been presented with an opportunity to vote on the Company's non-employee director compensation.

37. Thus, lacking shareholder approval and standing at a level several times greater than that of its peers (and, in fact, rivalling or far exceeding the compensation levels of even the very largest public companies and bio-pharmaceuticals companies, in particular), the excessive compensation taken by Denali's Non-Employee Director Defendants' harms the Company and its shareholders, including the Plaintiff.

38. Among other things, having a compensation plan that is entirely discretionary, not shareholder approved, and lacking any meaningful limitations or alignment to the long-term interests of Denali and its shareholders is untenable because it gives the Non-Employee Director Defendants a blank check to write themselves year after year. Such unchecked, self-dealing wastes valuable and precious corporate assets and will continue to cause harm the Company and its shareholders if not stopped.

39. At bottom, Denali's director compensation practices and policies are the antithesis of prudent corporate governance and stewardship.

DERIVATIVE AND DEMAND FUTILITY ALLEGATIONS

40. Plaintiff brings this action derivatively in the right and for the benefit of Denali to redress injuries suffered, and to be suffered, by the Company as a direct

result of breaches of fiduciary duty and unjust enrichment, as well as the aiding and abetting thereof, by the Director Defendants.

41. Denali is named as Nominal Defendant solely in a derivative capacity. This is not a collusive action to confer jurisdiction on this Court that it would not otherwise have.

42. Plaintiff will adequately and fairly represent the interests of Denali in enforcing and prosecuting its rights.

43. Plaintiff was a shareholder of Denali at the time of the wrongdoing complained of, has continuously been a shareholder since that time, and is a current Denali shareholder.

44. The current Board of Denali consists of the following nine individuals: defendants Sato, Watts, Cole, Cook, Flatley, Klein, Nelsen, Schenkein, and Tessier-Lavigne.

45. Because Director Defendants Flatley, Nelsen, and Tessier-Lavigne approved the compensation at issue here and all the Non-Employee Director Defendants receive the challenged compensation, the Director Defendants stand on both sides of the compensation awards.

46. All eight Non-Employee Director Defendants received or stand to receive the challenged compensation, and thus derived or stand to derive a personal financial benefit from and had a direct interest in the transactions at issue in this

case. The Director Defendants therefore lack disinterest and will have the burden of proving the entire fairness of their compensation.

47. There is more than a reasonable doubt that the directors could impartially consider a demand on themselves.

48. Further, each of the Director Defendants has wasted the Company's assets by agreeing to and awarding or accepting to be awarded the improper compensation detailed herein as no disinterested director would take advantage of the opportunity to award compensation well beyond a company's peers and in utter disregard of the Company's financial operations.

49. Plaintiff declined to serve a litigation demand on the Board because it is readily apparent that such an effort would have been futile based upon, *inter alia*:

a. the fact that Non-Employee Director Defendants stand on both sides of the challenged compensation awards having approved the compensation and being past and future beneficiaries of the challenged compensation;

b. all Non-Employee Director Defendants received and stand to receive the challenged compensation, and thus derived and stand to derive substantial personal financial benefit from the transactions at issue; and

c. each of the Non-Employee Director Defendants has wasted the Company's assets by accepting (or agreeing to accept) the improper compensation detailed herein as no disinterested director would take advantage of the opportunity to award compensation far beyond the Company's peers and in utter disregard of the Company's financial performance and market value.

50. Based on the allegations herein, specifically the fact that the Board has approved grossly-excessive compensation for its non-employee members without regard to meaningful limits, its peers, or the Company's finances, and without shareholder approval, it is apparent that the Non-Employee Director Defendants are self-interested, lack independence, and that the challenged compensation practices and policies do not meet the threshold requirement of entire fairness to the Company and its shareholders.

51. Further, the Non-Employee Director Defendants could not independently consider a pre-suit demand for litigation because doing so would require them to scrutinize their own conduct relating to the excessive compensation they approved for themselves. In other words, "[i]t strains reason to [believe] that a defendant–director could act independently to evaluate the merits of bringing a legal action against any of the other defendants if the director participated in the identical challenged misconduct." *In re Inv'rs Bancorp, Inc. Stockholder Litig.*, 177 A.3d 1208, 1226 (Del 2017), as rev. (Dec. 19, 2017).

52. Accordingly, demand is futile, and thus, excused.

FIRST CAUSE OF ACTION

Against the Director Defendants for Breach of Fiduciary Duty

53. Plaintiff incorporates by reference and realleges each and every allegation contained above, as though fully set forth herein.

54. The Director Defendants and each of them, violated their fiduciary duty of loyalty by awarding or receiving excessive and improper compensation at the expense of the Company.

55. As a direct and proximate result of the Director Defendants' breaches of their fiduciary obligations, Denali has sustained significant damages, as alleged herein.

56. As a result of the misconduct alleged herein, the Director Defendants are liable to the Company.

57. Plaintiff, on behalf of Denali, has no adequate remedy at law.

SECOND CAUSE OF ACTION

Against the Non-Employee Director Defendants for Unjust Enrichment

58. Plaintiff incorporates by reference and realleges each and every allegation contained above, as though fully set forth herein.

59. By their wrongful acts and omissions, the Non-Employee Director Defendants were unjustly enriched at the expense of and to the detriment of Denali.

60. The Non-Employee Director Defendants were unjustly enriched as a result of the compensation they received while breaching fiduciary duties owed to Denali.

61. Plaintiff, as shareholder and representative of Denali, seeks restitution from the Non-Employee Director Defendants, and each of them, and seeks an order of this Court disgorging all profits, benefits, and other compensation obtained by these defendants, and each of them, from their wrongful conduct and fiduciary breaches.

62. Plaintiff, on behalf of Denali, has no adequate remedy at law.

THIRD CAUSE OF ACTION

Against the Director Defendants for Waste of Corporate Assets

63. Plaintiff incorporates by reference and realleges each and every allegation contained above, as though fully set forth herein.

64. As a result of the Director Defendants' self-dealing, the Company has wasted its valuable assets by paying the Non-Employee Director Defendants excessive compensation.

65. As a result of the waste of corporate assets, the Director Defendants are liable to the Company.

66. Plaintiff, on behalf of Denali, has no adequate remedy at law.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff, on behalf of Denali, demands judgment as follows:

A. Against all of the Director Defendants and in favor of the Company for the amount of damages sustained by the Company as a result of the Director Defendants' breaches of fiduciary duties, unjust enrichment, and waste of corporate assets;

B. Directing the Board to take all necessary actions to reform and improve its corporate governance and internal procedures to comply with applicable laws and to protect Denali and its shareholders from a repeat of the damaging events described herein. In particular, the Board must incorporate a meaningful limitation on the compensation it may award itself, and references to the Company's financial performance to its compensation plan and then present such changes to the shareholders for a vote;

C. Extraordinary equitable and injunctive relief as permitted by law, equity, and state statutory provisions sued hereunder, including attaching, impounding, imposing a constructive trust on, or otherwise restricting the proceeds of defendants' trading activities or their other assets so as to assure that Plaintiff on behalf of Denali has an effective remedy;

D. Awarding to Denali restitution from Non-Employee Director Defendants, and each of them, and ordering disgorgement of all profits, benefits, and other compensation obtained by the Non-Employee Director Defendants;

E. Awarding to Plaintiff the costs and disbursements of the action, including reasonable attorneys' fees, accountants' and experts' fees, costs, and expenses; and

F. Granting such other and further relief as the Court deems just and proper.

Dated: September 10, 2020

Respectfully submitted,

COOCH AND TAYLOR, P.A.

/s/ Blake A. Bennett

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