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IN THE SUPREME COURT OF THE STATE OF DELAWARE

CITIGROUP INC., CHARLES PRINCE, VIKRAM PANDIT, GARY CRITTENDEN, ROBERT RUBIN, ROBERT DRUSKIN, THOMAS G. MAHERAS, MICHAEL STUART KLEIN, DAVID C. BUSHNELL,

Defendants Below, Appellants,

v.

AHW INVESTMENT PARTNERSHIP, MFS, INC., ANGELA H. WILLIAMS, as Trustee of the Angela H. Williams Grantor Retained Annuity Trust UAD March 24, 2006, the Angela Williams Grantor Retained Annuity Trust UAD April 17, 2006, the Angela Williams Grantor Retained Annuity Trust UAD May 9, 2006, the Angela Williams Grantor Retained Annuity Trust UAD November 1, 2007, the Angela Williams Grantor Retained Annuity Trust UAD May 1, 2008, the Angela Williams Grantor Retained Annuity Trust UAD July 1, 2008, and the Angela Williams Grantor Retained Annuity Trust UAD November 21, 2008,

Plaintiffs Below, Appellees.

No. 641, 2015

Certification of Question of Law from the United States Court of Appeals for the Second Circuit
C.A. Nos. 13-4488-cv(L), 13-4504-cv(XAP)

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Preliminary Statement

The core teaching of *Tooley* v. *Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), is that whether a claim is direct or derivative turns on who suffered the relevant primary economic harm, and who, if anyone, should be entitled to recover for that harm. Plaintiffs concede that they, as holders, were not harmed by, and cannot seek damages predicated on, any distortion in the price of Citigroup shares. Citi Br. 12, 21-22. Plaintiffs' claims are instead based entirely on harm suffered by Citigroup, which directly suffered the loss in value of its subprime-related assets. Plaintiffs' theory of harm rests on their allegations that over a period of 22 months from May 2007 to March 2009, the undistorted value of Citigroup's subprime assets declined; the intrinsic value of Citigroup as a business therefore declined; and the undistorted value of Citigroup shares therefore declined. *Id.* at 1, 4. During that period, plaintiffs retained their Citigroup shares.

After the fact, plaintiffs alleged that if they had known supposedly undisclosed facts, they would hypothetically have sold in May 2007 at the peak of the market. Plaintiffs seek the amount of the entire decline in the undistorted value of their shares for the 22 months after the date of their hypothetical sale, or $48.50 per share. *Id*. at 10-12, 26-27. But because that decline in undistorted share value simply reflects a loss in value of Citigroup assets, plaintiffs' theory could state only a derivative claim.

Citigroup would be the proper plaintiff to recover for that loss, to the extent it is legally compensable. If Citigroup's loss had really resulted from mismanagement, as plaintiffs' Complaint pleads (*id*. at 11), then under circumstances defined by Delaware law, Citigroup could have recovered against its directors and officers for breach of fiduciary duty. Plaintiffs' brief reiterates their charge of mismanagement: that brief asserts that "Citigroup's credit management . . . was atrocious" and that "80% of Citigroup's loans in 2007 were defective." AHW Br. 7.[1] In fact, however, derivative actions brought on behalf of Citigroup for this loss in asset value failed for failure to plead that demand was excused or improperly rejected. Citi Br. 11 n.4, 28-29.

Plaintiffs suggest that because these derivative actions failed, they should be permitted to bring direct actions. But it remains true that under *Tooley*, Citigroup, and not its shareholders, was the proper plaintiff. Moreover, allowing direct actions because derivative actions failed, as plaintiffs request, would completely subvert the important principles of Delaware law that led to the failure of the derivative actions in the first place. *Id.* at 28-29.

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[1] Elsewhere in their brief, plaintiffs inconsistently suggest that Citigroup's subprime assets were a "bet that may have paid off handsomely." AHW Br. 17. But the narrative in the Complaint, which emphatically alleges mismanagement, is controlling. And even if the allegations of mismanagement were stripped from the Complaint, plaintiffs' claims would still be derivative under *Tooley*. That is so because the alleged harm underlying those claims would still be a decline in value of Citigroup's subprime assets, which was an economic injury to Citigroup. Plaintiffs could still not prevail without showing an injury to Citigroup.

Plaintiffs respond to this straightforward application of *Tooley* with incredulity. Plaintiffs say that they decided not to sell their shares in reliance on misstatements. Allegedly for that reason, plaintiffs remained Citigroup stockholders during a long period when *Citigroup* was suffering losses in the value of its subprime assets. "It cannot be," plaintiffs tell this Court, that their claims are derivative in nature, because in their view, that result would effectively deny them any remedy for the alleged misstatements. AHW Br. 2. But that argument faces an insurmountable obstacle: plaintiffs cannot show they suffered any injury by reason of the alleged misstatements that is independent of an injury to Citigroup. *See* Citi Br. 12, 21-22. Plaintiffs' alleged reliance on misstatements is not itself an economic harm.

Under the *Tooley* test, the same harm cannot have been suffered both in the first instance by the corporation (thus giving rise to a derivative claim) and independently by a stockholder (thus giving rise to a direct claim).[2] If that were possible, the *Tooley* test would fail to prevent the assertion of duplicative claims for the same harm by both stockholders and the corporation, and would fail to

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[2] As plaintiffs note, "'the same set of facts can give rise both to a direct claim and a derivative claim.'" AHW Br. 17-18 (citing *Grimes* v. *Donald*, 673 A.2d 1207, 1212 (Del. 1996)). But that can occur only when the same set of facts gives rise to "separate harms"—i.e., separate economic injuries—to the corporation and to the stockholders, and when these separate harms are "independent of each other." *Gentile* v. *Rossette*, 906 A.2d 91, 99 (Del. 2006). Plaintiffs here allege no such separate harms.

prevent evasion, through spurious direct actions, of the Delaware law governing derivative actions. *Id*. at 28-30.[3]

Here, Citigroup suffered the loss in value of its subprime assets, which is the relevant economic harm. Accordingly, plaintiffs may not assert direct claims. That result is entirely just. As defendants have shown, a *purchaser* who bought shares on the day of defendants' hypothetical sale would not ordinarily be entitled to recover the damages that plaintiffs seek. Citi Br. 27 n.27. A purchaser's damages would ordinarily be limited to the amount of the fraudulent inflation on the date of the purchase, which here was allegedly $3.41 per share. *Id*. at 10, 26-27.

Plaintiffs' appeal to fairness therefore comes to this: the straightforward application of *Tooley* urged by defendants may deny plaintiffs any recovery because plaintiffs will have no direct claim for $48.50 per share in purported damages (even though a purchaser could not obtain these damages), and because the separate derivative actions against Citigroup's directors and officers for alleged mismanagement of its subprime-related assets failed under Delaware law. There is no unfairness at all in that result.

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[3] *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 773 (Del. 2006) ("[I]f the plaintiffs' damages theory is valid, the directors of an acquiring corporation would be liable to pay both the corporation and its shareholders the same compensatory damages for the same injury. That simply cannot be." (footnote omitted)).

Argument

I. Stock-Drop Claims by Holders Are Derivative Under the *Tooley* Test

To bring a direct claim, a stockholder must allege an injury to itself that is "independent of any injury to the corporation" and must show that it can prevail "without showing an injury to the corporation." *Tooley*, 845 A.2d at 1038-39. The Second Circuit suggested that this statement of the direct-injury test in *Tooley* might be inconsistent with *Tooley*'s rejection of the different special-injury test. Ex. A, at 14, 24. As defendants have demonstrated, no such inconsistency exists. Citi Br. 17-20. Plaintiffs now concede that point.[4] As plaintiffs' claims do not satisfy the direct-injury test, those claims are derivative.

A. Plaintiffs Cannot Demonstrate an Injury that Is Independent of Injury to Citigroup

Tooley requires identification of the alleged "economic injury" that underlies plaintiff's claim for damages. *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 826 (Del. Ch. 2005), *aff'd*, 906 A.2d 766 (Del. 2006). For the claim to be direct, that economic injury must be suffered "*in the first instance*" by the stockholder rather than the corporation. *Culverhouse* v. *Paulson & Co. Inc.*, 2016 WL 304186, at *3 (Del. Jan. 26, 2016) (emphasis added). Here, plaintiffs "measure[ ] their damages based on the lost value of their shares." AHW Br. 18.

[4] *See* AHW Br. 18 ("Under *Tooley*, what matters is whether the shareholder suffered some harm independent from injury to the corporation.").

Plaintiffs affirmatively allege that their Citigroup shares lost undistorted value only because the value of Citigroup's subprime assets declined. Citi Br. 10-12, 18, 20-22. And plaintiffs must prove a decline in the value of Citigroup's subprime assets in order to establish their theory of causation. (*See* A14-15 ¶ 7, A75 ¶ 225.) That decline in value is an injury to Citigroup. It is therefore plain that "[t]he alleged harm flowing from [Citigroup's] losses would not in the first instance be suffered by [plaintiffs]." *Culverhouse*, 2016 WL 304186, at *3. Citigroup suffered that harm first.

Plaintiffs argue that they have shown the independent injury *Tooley* requires by alleging that they were owed a direct duty. According to plaintiffs, "[t]he harm the Williamses suffered was Citigroup's violation of [a] tort-law duty." AHW Br. 16. But *Tooley* requires *both* a direct duty *and* a direct injury. "The stockholder must demonstrate that the duty breached was owed to the stockholder ***and*** that he or she can prevail without showing an injury to the corporation." *Tooley*, 845 A.2d at 1039 (emphasis added). If a direct duty were enough, the direct/derivative distinction would have little or no independent significance, because in order to state a tort claim under the applicable substantive law, a plaintiff is required to allege the breach of a duty owed to it.

Similarly, plaintiffs theorize that a stockholder's reliance on misstatements constitutes an "injury" that is independent from harm to the

corporation. AHW Br. 15-19. But reliance itself is not an economic harm. And this Court has rejected plaintiffs' theory: under the Court's case law, claims alleging reliance on misstatements are derivative if the underlying economic harm is a harm to the corporation. Citi Br. 22-25.

In *J.P. Morgan*, for example, as here, the plaintiff stockholders sought to assert a direct claim based on allegations that plaintiffs relied on misstatements, and that their reliance caused the value of their shares to decline. *See* Citi Br. 25-26. More specifically, the *J.P. Morgan* plaintiffs alleged that the stockholders of J.P. Morgan Chase & Co. ("JPMC") were induced to approve a merger by misstatements in proxy materials. 906 A.2d at 772. As a result of the merger, JPMC's pre-merger stockholders allegedly suffered "a dilution of the proportionate economic value . . . of [their] shares." *Id*. This Court held that the claim rested on an economic harm to JPMC and could therefore be brought only by or on behalf of JPMC. *J.P. Morgan* demonstrates that reliance is not an independent harm under *Tooley*.[5]

Plaintiffs purport to distinguish *J.P. Morgan* because it involved a misrepresentation-based claim for breach of fiduciary duty, rather than a claim for

[5] *Manzo* v. *Rite Aid Corp.* also held that a claim alleging reliance was derivative. 2002 WL 31926606, at *5 (Del. Ch. Dec. 19, 2002) (holding that any claim that plaintiff was "deprived of accurate information upon which to base investment decisions" would be derivative), *aff'd*, 2003 WL 21262118 (Del. May 29, 2003).

fraud. AHW Br. 26-27. In its *Culverhouse* decision, however, this Court recently confirmed that *Tooley* applies to tort claims. In addition to a claim for breach of fiduciary duty, *Culverhouse* involved claims for gross negligence and unjust enrichment. 2016 WL 304186, at *2. This Court held that all of the claims were derivative under *Tooley*. *Id.* at *3. Like *Culverhouse*, many courts have applied the *Tooley* test, under Delaware law and under the laws of other states that have adopted that test, to determine that both claims for breach of fiduciary duty *and* other tort claims, including "holder" claims sounding in fraud and negligent misrepresentation, were derivative. Citi Br. 16 n.10, 34 n.34. Plaintiffs do not cite a single case that has declined to apply the *Tooley* test, or the equivalent test of another state, to such tort claims.

To limit *Tooley* to claims for breach of fiduciary duty, which are a species of tort claim,[6] would make no sense. Almost any claim for waste, mismanagement, misrepresentations by a fiduciary, or other breach of fiduciary duty could be reframed as a claim for fraud, negligence, or some other non-fiduciary tort. For that reason, plaintiffs' proposed distinction would make it easy to evade *Tooley*.

Plaintiffs suggest that defendants have improperly focused on

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[6] *See In re Rural/Metro Corp. Stockholders Litig.*, 102 A.3d 205, 222 n.6 (Del. Ch. 2014) (collecting cases), *aff'd sub nom. RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816, 2015 WL 7721882, at *38 n.218 (Del. Nov. 30, 2015) ("find[ing] no error" in this conclusion).

plaintiffs' measure of damages, rather than the relevant harm. But the economic harm here was a decline in value of Citigroup's subprime assets. Reliance, or "Citigroup's fraud" in general (AHW Br. 18-19), are not economic harms.

Plaintiffs then note that if defendants' disclosures had been different, plaintiffs would allegedly have sold their shares and would hypothetically have avoided their losses. That, they say, suggests that plaintiffs have alleged a distinct harm. *Id.* But this conclusion simply does not follow: the actual harm plaintiffs allege, based on events as they allegedly unfolded in the real world, derives from a loss in the value of Citigroup's subprime assets.[7]

Next, plaintiffs suggest that because the derivative actions on behalf of Citigroup were dismissed for failure to plead that demand was excused or improperly rejected, Citigroup has not "suffered any 'injury' in the legal sense" from its subprime-related losses. AHW Br. 16-17. But *Tooley*'s first question asks only who suffered the relevant "harm." An additional requirement that the harm be "legally cognizable" would make no sense. Courts applying *Tooley* cannot practically be required to assess whether, if a hypothetical derivative action were

[7] Plaintiffs argue that not all Citigroup stockholders could assert meritorious holder claims, and thus that plaintiffs have suffered a "special injury." AHW Br. 19. That is not accurate, because the relevant economic harm was suffered derivatively by all contemporaneous Citigroup stockholders. In any event, the *Tooley* test, not the special-injury test, is the governing standard.

brought, the harm underlying that action would be "legally cognizable."[8] And in substance, plaintiffs suggest that they may bring a direct claim *for the very reason that the derivative actions failed*, even though such a rule would completely nullify the Delaware law limiting derivative actions, including the demand requirement.

For these reasons, at least 22 decisions from courts outside Delaware (applying both Delaware law and the law of other states) have held that "holder" claims are derivative. Citi. Br. 16 nn.10-11. Plaintiffs purport to distinguish only 10 of these 22 decisions. AHW Br. 30-31 & nn.6-7. And plaintiffs' purported distinctions are unsound. *First*, plaintiffs claim that 5 of these decisions did not involve reliance. *Id.* at 30 n.6. But as demonstrated above, an allegation of reliance does not permit the assertion of a direct action based on a harm to the corporation. Plaintiffs do not dispute that reliance was alleged in at least 17 of the 22 cases. And in fact, reliance was also alleged in most of the cases that plaintiffs do dispute.[9] *Second*, plaintiffs note that 5 of these decisions involved claims

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[8] Dismissal of the derivative complaints against Citigroup officers for failure to plead that demand was excused or improperly rejected does not constitute a finding that Citigroup's officers did not cause legally cognizable injury to the corporation. Citigroup's position, of course, is that its officers did not cause any such injury.

[9] *See Crocker* v. *Fed. Deposit Ins. Corp.*, 826 F.2d 347, 350 & n.4 (5th Cir. 1987) (noting the weakness of plaintiffs' reliance allegation, but assuming that plaintiffs adequately pleaded a "lost profit opportunity," i.e., that plaintiffs "would have sold" but for the misstatements); *Melgen* v. *Bank of Am. Corp. (In re Bank of Am. Corp. Sec., Deriv. & ERISA Litig.)*, 2013 WL 6504801, at *11-13 (S.D.N.Y. Dec. 11, 2013) (noting that reliance was alleged but finding that it was not alleged with the required heightened specificity); *Sweet* v. *Killinger (In re Wash. Mut., Inc. Sec., Deriv. & ERISA Litig.)*, 2010 WL 2803033, at *3, *6 (W.D.

against defendants external to the corporation, such as auditors. *Id.* at 30 n.7. But the *Tooley* test does not depend on the identity of the defendant, and these 5 cases do not suggest otherwise. Moreover, plaintiffs' distinction implies that claims by the same stockholder plaintiffs, based on the same harm, could be direct when stated against corporate officers and derivative when stated against external defendants.[10] That would make no practical or conceptual sense.

B. Citigroup Should Receive the Benefit of Any Monetary Remedy

Citigroup suffered the loss in value of its subprime assets. And Delaware law afforded Citigroup (or a derivative plaintiff) a remedy for that loss if a breach of fiduciary duty by Citigroup officers or directors had caused the loss, and if Citigroup (or a derivative plaintiff) had satisfied the other requisites for recovery under Delaware law. These circumstances alone warrant a finding that for purposes of *Tooley*'s second prong, Citigroup should receive the benefit of any monetary remedy. Citi Br. 28. In evaluating *Tooley*'s second prong, this Court may also properly consider the purposes and functioning of the direct/derivative distinction under Delaware law. Citi Br. 28-32.

Wash. July 15, 2010) (same); *In re WorldCom, Inc.*, 323 B.R. 844, 854 (Bankr. S.D.N.Y. 2005) (noting plaintiffs' allegation that misstatements "induced plaintiffs to hold their shares").

[10] Plaintiffs' distinction is contradicted by plaintiffs' amicus, which incorrectly asserts that holder claims against external defendants are necessarily direct. *See* PIABA Br. 2, 12-14.

1. Direct Stock-Drop Claims by Holders Would Interfere with Settled Delaware Law

Permitting direct stock-drop holder claims would risk double recovery by the corporation and by individual stockholders, which this Court found unacceptable in *J.P. Morgan*. 906 A.2d at 773 & n.18; *see* Citi Br. 29-30; *see also supra*, p. 4 n.3.[11] Plaintiffs' only response is that the value of corporate claims is incorporated into the stock price, and thus reduces the stock-price decline that is the basis for the individual stockholder's claim for damages. AHW Br. 33-34. But at most, the stock price will incorporate only the perceived likelihood of success of any potential or actual derivative action based on highly imperfect information. *See In re El Paso Pipeline Partners, L.P. Deriv. Litig.*, 2015 WL 7758609, at *44 (Del. Ch. Dec. 2, 2015). The risk of double recovery thus remains unacceptably high. Plaintiffs also do not address the severe problems of damages allocation, sequencing, case management, and fairness to defendants that encouraging

[11] Amicus PIABA argues that a corporation's claims against defendants external to the corporation may be barred by doctrines such as *in pari delicto*, and thus that holder claims may be the only remedy. PIABA Br. 12-14 (citing *Kirschner* v. *KPMG LLP*, 938 N.E.2d 941 (N.Y. 2010)). The rejoinder to this argument is found in *Kirschner* itself: "why should the interests of innocent stakeholders of corporate fraudsters trump those of innocent stakeholders of the outside professionals who are the defendants in these cases?" 938 N.E.2d at 958. The fact that some meritorious defense is available in a lawsuit by a directly injured corporation is no reason to permit lawsuits by the corporation's indirectly injured stockholders. To the contrary, allowing such stockholder lawsuits would improperly nullify the defense. In any event, officers and directors, such as the individual defendants here, have no *in pari delicto* defense. *See, e.g.*, *Krys* v. *Sugrue (In re Refco Inc. Sec. Litig.)*, 2011 WL 6091700, at *3 (S.D.N.Y. Nov. 27, 2011).

duplicative actions would create.

If holders were permitted to assert direct stock-drop claims, Delaware's limitation on derivative actions would be easily circumvented. Citi Br. 28-29. Moreover, plaintiffs contend that they should be permitted to bring a direct action for a fraudulent or *negligent* misrepresentation. *See* AHW Br. 10. Negligence is a much lower standard of liability than the scienter-based standard that would apply under Delaware law in a derivative or other action based on alleged misstatements by corporate officers. *See Metro Commc'n Corp. BVI* v. *Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 130-32, 155-163 (Del. Ch. 2004). Allowing direct negligence-based actions by holders for economic injury to the corporation would thus "conflict with" and "in essence undercut" Delaware's "important policy choice" concerning "the extent to which a business fiduciary should be held responsible for misleading disclosures." *Id.* at 132, 155.

2. Classifying Holder Claims as Derivative Does Not Interfere with the Federal Securities Laws

Purchase claims are direct because a purchaser alleges that it was induced by fraudulent misrepresentations to enter into an actual transaction in which it paid a fraudulently inflated price. In contrast, the harm underlying plaintiffs' holder claims is harm to Citigroup. Citi Br. 20-22.

According to plaintiffs, this simple explanation is incompatible with the Second Circuit's "materialization of a concealed risk" doctrine. AHW Br. 20-

22. Plaintiffs, however, are mistaken. In all circumstances that are analogous to this case, a purchaser or seller seeking damages under the federal securities law cannot recover unless it paid a fraudulently inflated price or received a fraudulently understated price in an actual transaction.[12] In addition, a purchaser must prove that after its purchase, the price of the security declined for a reason causally related to the misrepresentation. "Materialization of a concealed risk" refers to one of the ways to prove that causal connection.[13] That doctrine, however, does *not* mean that a purchaser who paid $20 for a security that was actually worth $20 on the transaction date can recover. The doctrine therefore does not call into question defendants' explanation for why purchase and sale claims, unlike stock-drop holder claims, are direct.

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[12] *E.g.*, *Glickenhaus & Co.* v. *Household Int'l, Inc.*, 787 F.3d 408, 415 (7th Cir. 2015) ("To prove [loss causation], the plaintiffs had the burden to establish that the price of the securities they purchased was 'inflated'—that is, it was higher than it would have been without the false statements—*and* that it declined once the truth was revealed." (emphasis added)); *In re Delcath Sys., Inc. Sec. Litig.*, 36 F. Supp. 3d 320, 336 (S.D.N.Y. 2014) ("To plead loss causation, a plaintiff must allege that it purchased securities at an inflated price and that the price dropped once the fraud became known."); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 565 (S.D.N.Y. 2011) ("[W]ell-established loss causation principles . . . permit a party to recover only if [it] can show that [it] purchased shares at an inflated price *and* that the share price fell after the truth concealed by the fraud became known." (emphasis in original)); 5E Arnold S. Jacobs, Disclosure & Remedies Under the Securities Laws § 20:7, at 20-41 (2015) ("A plaintiff . . . recovers nothing under [the standard out-of-pocket] measure [of damages] if, on [the date of the questionable transaction], the fair value of what he receives equals the fair value of what he delivers.") (collecting cases). Exceptions can arise in, for example, certain claims by a customer alleging broker misconduct, *see, e.g.*, *Chasins* v. *Smith, Barney & Co.*, 438 F.2d 1167, 1173 (2d Cir. 1970), but those exceptions do not call into question defendants' explanation of why purchase and sale claims are ordinarily direct.

[13] *E.g.*, *Carpenters Pension Trust Fund* v. *Barclays PLC*, 750 F.3d 227, 232-33 (2d Cir. 2014).

Even if there were a conflict between the federal securities laws and *Tooley*, the federal courts are equipped to resolve that conflict. The federal courts apply state direct/derivative law to federal statutory claims only "to the extent such law is consistent with the policies" of those statutes. *Burks* v. *Lasker*, 441 U.S. 471, 486 (1979). This Court should not distort Delaware law based on an illusory conflict with federal law.

3. Classifying Holder Claims as Derivative Does Not Interfere with Other States' Substantive Laws Governing Fraud Claims

Delaware can and should apply *Tooley* to this case. Plaintiffs argue that concluding that holder claims are derivative will somehow interfere with the substantive securities laws of other states. AHW Br. 31-34. Not so. Under the internal affairs doctrine, Delaware law governs whether claims arising from a decline in the value of the assets of Citigroup (a Delaware corporation) belong to stockholders or to the corporation. A9-10. That threshold determination is not an improper interference with the laws of any other state.

Courts applying the laws of nine states other than Delaware have already held holder claims to be derivative. Citi Br. 16 n.10. There is no logical or doctrinal inconsistency between those holdings and the substantive laws of states that have chosen to recognize some holder claims. Indeed, the common law in three states—California, Georgia, and Texas—*both* permits some holder claims

and classifies holder claims as derivative. *Id.* at 15-16 nn.9-10. In California and Texas, the very decisions permitting some holder claims as a matter of substantive law also expressly reserved the direct/derivative issue.[14] No court has ever suggested that deeming holder claims to be derivative constitutes an illegitimate infringement on the substantive law of other jurisdictions.

II. Plaintiffs Rely on Inapposite Cases

Plaintiffs cite a dozen decisions that they assert have concluded that holder claims are direct. AHW Br. 22, 28-30 & nn.3-4. The vast majority of these cases do not involve stock-drop claims by stockholders *of business corporations*, much less *publicly traded corporations* like Citigroup. Nearly all of plaintiffs' cases involve investment companies such as hedge funds organized as limited partnerships or similar entities.[15] Others are even farther afield.[16]

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[14] *See, e.g.*, *Small* v. *Fritz Cos., Inc.*, 65 P.3d 1255, 1266 n.3 (Cal. 2003) ("express[ing] no view" on direct/derivative issue); *Grant Thornton LLP* v. *Prospect High Income Fund*, 314 S.W.3d 913, 929 n.26 (Tex. 2010) ("express[ing] no opinion" on the direct/derivative issue). Plaintiffs claim *Small* supports their view (AHW Br. 29), but fail to mention this footnote. This issue was not before the *Small* court because the defendants there had waived the issue. *See Greenfield* v. *Fritz Cos., Inc.*, 98 Cal. Rptr. 2d 530, 535-36 (Cal. Ct. App. 2000). A California case subsequent to *Small* held that holder claims are derivative in nature under California law. Citi Br. 16 n.10. *Small* also did not distinguish, as plaintiffs say (AHW Br. 29), between stockholders who plead reliance and stockholders who do not plead reliance, but rather between stockholders who plead reliance *with specificity* and "the mass of stockholders *who rely on the market*." 65 P.3d at 1266 (emphasis added).

[15] This is true of all but one of the cases that, according to plaintiffs, apply Delaware law. *See* AHW Br. 22, 28-29 & n.3 (citing *Albert* v. *Alex. Brown Mgmt. Servs., Inc. (Albert II)*, 2005 WL 2130607 (Del. Ch. Aug. 26, 2005); *In re Harbinger Capital Partners Funds Investor Litig.*, 2013 WL 5441754 (S.D.N.Y. Sept. 30, 2013); *Saltz* v. *First Frontier, L.P.*, 782 F. Supp. 2d 61 (S.D.N.Y. 2010); *Anwar* v. *Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372

Investment Company Cases. The investment company cases involve contractual disclosure obligations and contractual redemption rights that are absent in stock-drop holder claims involving publicly traded business corporations. *See In re Parkcentral Global Litig.*, 2010 WL 3119403, at *6 & n.59 (N.D. Tex. Aug. 5, 2010) (noting that such companies must be viewed "[i]n contrast to a publicly traded company" for purposes of applying *Tooley* to holder cases). The results in such cases, whether or not they are correct, should not be extended to cases like this one.

Albert illustrates why holder cases involving investment companies can present special issues. In *Albert*, plaintiffs invested in tax-driven "exchange funds," which allowed participants to avoid capital gains taxes on the securities that they contributed to the fund. *Albert* v. *Alex. Brown Mgmt. Servs., Inc. (Albert I)*, 2005 WL 1594085, at *1-2 (Del. Ch. June 29, 2005) (prior opinion on same motion). As limited partners, plaintiffs had a "contractual right," under the limited

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(S.D.N.Y. 2010); *In re Parkcentral Global Litig.*, 2010 WL 3119403 (N.D. Tex. Aug. 5, 2010)). It is also true of some of the cases that plaintiffs acknowledge apply non-Delaware law. *See* AHW Br. 30 n.4 (citing *Robeco-Sage Capital, L.P.* v. *Citigroup Alternative Invs. LLC*, 2009 WL 2626244 (N.Y. Sup. Ct. July 28, 2009); *Pension Comm. of Univ. of Montreal Pension Plan* v. *Banc of Am. Sec., LLC*, 446 F. Supp. 2d 163 (S.D.N.Y. 2006)).

[16] *See* AHW Br. 30 n.4 (citing *Univ. of Md.* v. *Peat Marwick Main & Co.*, 923 F.2d 265 (3d Cir. 1991) (*Burford* abstention not appropriate in insurance policyholders' suit against insurer's auditor); *Fraternity Fund Ltd.* v. *Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 407-08 (S.D.N.Y. 2005) (not deciding any direct/derivative issue, but rather whether a fraud claim was duplicative of a claim for breach of contract)).

partnership agreement, to receive audited financial statements, and defendants also had a "contractual duty . . . to disclose all material information." *Albert* v. *Alex. Brown Mgmt. Servs., Inc. (Albert II)*, 2005 WL 2130607, at *3-4, *7 (Del. Ch. Aug. 26, 2005). The Court of Chancery's ruling on the direct/derivative issue specifically cited these contractual rights, and did not analyze fiduciary disclosure claims separately from the contractual disclosure claims. *Id.* at *12-13. Stockholders in publicly traded corporations, of course, have no such contractual disclosure rights.

There is also a difference between contractual redemption rights and the sale of stock. In *Albert*, for example, the redemptions would have been "limited to the investor contributed securities, and to those contributed securities fair market value, at the time of redemption." *Albert I*, 2005 WL 1594085, at *5 n.11.[17] Thus, the gravamen of plaintiffs' claim was *not* that they would have

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[17] Redemptions prior to the "tax anniversary" of the relevant fund were limited in the way stated in text. All of the alleged disclosure violations occurred before the tax anniversary of the second fund, and nearly all also occurred before the tax anniversary of the first fund. *Albert II*, 2005 WL 2130607, at *1; *Albert I*, 2005 WL 1594085, at *2 n.6. Because plaintiffs alleged that the correction of any of these misstatements would have caused them to redeem, even as to the first fund, plaintiffs necessarily alleged that they would have redeemed before the tax anniversary. This was also the case because the funds' managers froze all redemptions, as they were allowed to do, before the second funds' tax anniversary and very shortly after the first funds' tax anniversary. *Albert I*, 2005 WL 1594085, at *6, *17. Furthermore, even if *Albert* can be read to allege that plaintiffs would have redeemed after the tax anniversary, the result is not materially different. In that case, plaintiffs would have received securities selected by the funds' managers based on "quarter-end at NAV" valuations. *Id.* at *5 n.11. Because the NAVs were alleged to be inflated, these contract-based redemptions also would not have depended upon the actual value of the funds. *See*

redeemed before the *funds' total value* declined. Rather, the claim was that they lost a contractual right to redeem at a valuation that would *not* have been based on the funds' total value.

Business Corporation Cases. Tellingly, only two of plaintiffs' direct/derivative cases involve stock in business corporations. The first, an Illinois trial court opinion, completely mischaracterizes *Manzo* by incorrectly asserting that *Manzo* "deemed Ms. Manzo's holder claim to be a direct not derivative action." *Gordon* v. *Buntrock*, 2004 WL 5565141, at *11 (Ill. Cir. Ct. 2004). The second, *Albers* v. *Edelson Tech. Partners L.P.*, 31 P.3d 821 (Ariz. Ct. App. 2001) (Arizona law), involved a claim that a fraud "rendered meaningless" the employee stock options of a non-publicly-traded corporation. *Id.* at 827. *Albers* noted that the plaintiff employees had been deprived of a contractual right to buy shares "at a discount." *Id.* Significantly, *Albers* suggested that the analysis would have been different for a claim "that the company has lost value and therefore the corporation's stock is worth less per share." *Id.*

III. The *Tooley* Test Applies to the Tort Claims at Issue Here

Plaintiffs argue that *NAF Holdings, LLC* v. *Li & Fung (Trading) Ltd.*, 118 A.3d 175 (Del. 2015), limited *Tooley* to breach of fiduciary duty claims alone.

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also Robeco-Sage, 2009 WL 2626244, at *12 (noting that plaintiffs were induced "not to redeem at the inflated NAV").

AHW Br. 24-26. Plaintiffs are wrong. The *NAF* Court's rationale and holding were entirely contract-based. Citi Br. 33-34. This Court's subsequent decision in *Culverhouse* confirms that *Tooley* applies to tort claims. *Supra*, pp. 5-6.[18] And contrary to plaintiffs' observations, *Tooley* and *Culverhouse* require *both* a direct duty *and* a direct injury. *Supra*, p. 6.[19]

Conclusion

Plaintiffs' claims are derivative in nature under Delaware law.

Respectfully submitted,

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18 *Culverhouse* did not, as plaintiffs claim, "identify[ ] the party owed the relevant duty" as a precondition to applying *Tooley*. AHW Br. 25. *Culverhouse* merely quoted the portion of *Tooley* quoted *supra*, p. 6.

19 Plaintiffs suggest that *NAF* may exempt from *Tooley* only fraud claims that belong "personally" to the plaintiff. AHW Br. 26. Plaintiffs do not identify any tort plaintiffs who would not be able to say, as plaintiffs do here, that they are pursing "their *own* tort claim" based on the "violation of a duty owed *to them*." *Id*. at 25; *cf. supra*, pp. 6-7. *Tooley* must at least apply to torts of nondisclosure like those at issue in this case, which can be and frequently are brought as claims for breach of fiduciary duty. Citi Br. 34 & n.33.

CERTIFICATE OF SERVICE

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