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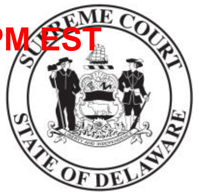

IN THE SUPREME COURT OF THE STATE OF DELAWARE

CHESTER COUNTY EMPLOYEES' RETIREMENT FUND,	)	
Plaintiff-Below, Appellant,	)	
v.	)	No. 457, 2017
NEW RESIDENTIAL INVESTMENT CORP., WESLEY R. EDENS, MICHAEL NIERENBERG, ALAN L. TYSON, DAVID SALTZMAN, KEVIN J. FINNERTY, DOUGLAS L. JACOBS, FIG LLC, FORTRESS INVESTMENT GROUP LLC and FORTRESS OPERATING ENTITY I LP,	)	CASE BELOW: Court of Chancery of the State of Delaware C.A. No. 11058-VCMR
Defendants-Below, Appellees.	)	

APPELLEES' ANSWERING BRIEF ON APPEAL

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NATURE OF THE PROCEEDINGS

New Residential Investment Corp. ("New Residential") is a publicly-held real estate investment trust. It has no employees, but is externally managed by FIG LLC ("FIG"), an affiliate of Fortress Investment Group LLC ("Fortress"). At the relevant time, Fortress and its affiliates owned approximately 2% of New Residential's voting stock and options to purchase another 5%.

In April 2015, New Residential bought substantially all of the assets of an unaffiliated third party, Home Loan Servicing Solutions, Ltd. ("HLSS," the "HLSS Acquisition"). In May 2015, Plaintiff-Appellant Chester County Employees' Retirement Fund filed a complaint in the Court of Chancery. Plaintiff's central claim is that Fortress influenced New Residential's directors to cause New Residential to overpay for HLSS's assets. Plaintiff alleged that Fortress controlled New Residential, that a majority of the New Residential board of directors lacked independence from Fortress, and that the New Residential directors supposedly agreed to overpay for HLSS's assets (and issue equity to do so) because Fortress (via an affiliate) would be paid more to manage New Residential if New Residential were bigger. Plaintiff alleged this claim directly (Count I), but also alleged a fallback derivative claim (Count II). Plaintiff also asserted claims for declaratory judgments about terms of New Residential's governance documents (Count III).

Defendants moved to dismiss the original complaint and filed an opening brief in support. Among other things, Defendants argued that Plaintiff's claim was exclusively derivative, and that Plaintiff failed to plead particularized facts sufficient to pass the *Aronson* test – specifically, that Plaintiff had not alleged particularized facts creating a reasonable doubt about the independence of a majority of New Residential's board from Fortress, and that, in any event, Plaintiff had not alleged particularized facts supporting a reasonable inference that Fortress had a material conflict of interest.

In response, Plaintiff filed an Amended and Supplemented Verified Class Action and Derivative Complaint (the "First Amended Complaint") on October 30, 2015. Defendants again moved to dismiss and renewed their arguments for dismissal, including that Fortress did not have a material conflict of interest in the HLSS Acquisition. Plaintiff elected not to further amend its complaint.

On October 7, 2016, the Court of Chancery granted Defendants' motion to dismiss in large part, and denied it for one aspect of Count III. The Court held that Plaintiff's overpayment claim was derivative, not direct, and dismissed Count I on that basis. The Court then held that Plaintiff had not satisfied *Aronson*, and dismissed Count II on that basis. The Court held that Plaintiff's allegations created a reasonable doubt as to the independence from Fortress of three of New Residential's six directors. However, the Court also held that because New

Residential's acquisition of HLSS's assets did not involve "self-dealing," but, at most, an alleged "side benefit" to Fortress, Plaintiff was required to plead facts supporting a reasonable inference that the alleged side benefit was material. The Court held that Plaintiff had not pleaded such facts, and also had not pleaded facts explaining why any alleged side benefit would motivate Fortress or New Residential's directors to cause New Residential to overpay for HLSS's assets. Because it dismissed Count II in its entirety on the basis of Rule 23.1, the Court did not reach or consider Defendants' alternative grounds for dismissal under Rule 12(b)(6). The Court further held that almost all of Count III was unripe. Although Plaintiff had already amended its complaint once, and elected to proceed to a ruling on Defendants' motion to dismiss, the Court gave Plaintiff leave to replead.

Rather than replead, Plaintiff moved for reargument. Plaintiff argued that the Court of Chancery erred by requiring Plaintiff to plead the materiality of Fortress's alleged interest, and argued that it had satisfied that requirement anyway. Plaintiff also argued that the Court should revisit its ruling rather than requiring Plaintiff to attempt to replead, because evolution in the composition of New Residential's board after the First Amended Complaint made it difficult for Plaintiff to plead demand futility. The Court of Chancery disagreed, and denied the motion for reargument, noting, among other things, that Plaintiff had not

responded to Defendants' arguments about materiality either in briefing or at oral argument on the motion to dismiss.

Plaintiff filed a Second Amended Verified Class Action and Derivative Complaint (the "Second Amended Complaint") on February 27, 2017. This pleading withdrew the one portion of Count III that had survived Defendants' prior motion to dismiss. Defendants moved to dismiss under Rule 23.1, which the Court of Chancery granted on October 6, 2017, holding that the Second Amended Complaint did not create a reasonable doubt as to disinterest and independence of a majority of the board at the time the Second Amended Complaint was filed.

This appeal followed.

Plaintiff's only basis for appeal is its argument that the Court of Chancery erred in dismissing Count II of the First Amended Complaint. Plaintiff does not appeal the dismissal of the Second Amended Complaint.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery correctly dismissed Plaintiff's derivative claim for failure to plead demand futility under the standard established by *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). The Court of Chancery correctly held that when a plaintiff argues that demand is excused because directors are not independent from an allegedly interested person, the plaintiff must either show that the allegedly interested person either engaged in "self-dealing" or received a side benefit that was material to it. The Court of Chancery correctly held the HLSS Acquisition was not "self-dealing" because no one from Fortress or New Residential stood on the HLSS side of the transaction.

2. Denied. The Court of Chancery correctly held that Plaintiff had not alleged facts supporting a reasonable inference that Fortress's alleged interest in the HLSS Acquisition was material to it. First, Plaintiff elected not to respond below to Defendants' arguments about materiality and therefore waived it as a basis for appeal. Second, the Court of Chancery correctly found that Plaintiff failed to allege facts from which the Court could reasonably infer that Fortress or the New Residential directors stood to benefit by causing New Residential to overpay for HLSS's assets. Third, the Court of Chancery correctly found that Plaintiff failed to allege facts from which the Court could reasonably infer that any purported benefit to Fortress from the HLSS Acquisition was material to Fortress.

3. As an alternative ground for affirmance, the Court of Chancery erred in holding that Plaintiff alleged particularized facts raising a material doubt as to the independence of New Residential director Douglas Jacobs from Fortress merely because Mr. Jacobs served as an outside Fortress director. Plaintiff does not allege that Mr. Jacobs has a disabling personal interest, only that he is a "dual fiduciary." But Mr. Jacobs owes no fiduciary duty to Fortress when acting in his capacity as a New Residential director. As a result, he had no conflict of duty either when considering the HLSS Acquisition or a hypothetical demand. Moreover, under this Court's precedent, a director is not disabled from considering a demand merely because the director also serves as a director of a potential defendant.

COUNTERSTATEMENT OF FACTS[1]

Because Plaintiff appeals only the dismissal of the First Amended Complaint, Plaintiff may not rely on facts that it did not allege until the Second Amended Complaint. Except where specifically noted for context, the facts in this Counterstatement are taken from the allegations in the First Amended Complaint and contracts referred to therein for their terms.

A. The Parties.

Plaintiff claims to hold common stock of New Residential. (A41 ¶ 11)

New Residential is a publicly traded real estate investment trust focused on investing in and managing residential real estate investments, including excess mortgage servicing rights and residential mortgage-backed securities. (A41-42 ¶ 12; AOB 7) New Residential has no employees, and is externally managed by FIG. (A42 ¶ 13) At the time of the HLSS Acquisition, the terms of FIG's relationship with New Residential were governed by a Second Amended and Restated Management Advisory and Agreement dated August 5, 2014 (the "Management Agreement"). (A43 ¶ 40; A588)

Wesley R. Edens, Kevin J. Finnerty, Douglas L. Jacobs, David Saltzman, Michael Nierenberg, and Alan L. Tyson constituted the New Residential board of directors at the time of the HLSS Acquisition. (A43-53 ¶¶ 14-39; A1426-37 ¶¶ 14-

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[1] Facts alleged are assumed true only for purposes of this appeal. Appellant's Opening Brief is cited as "AOB __."

41) (As reflected in the Second Amended Complaint, Mr. Edens resigned from the board when his term expired at the May 26, 2016 annual stockholders meeting (A1426 ¶ 14); non-party Andrew Sloves joined the board on July 13, 2016 (A1506 ¶ 178); and non-party Robert J. McGinnis joined the board on December 15, 2016 (A1502-03 ¶ 170).)

FIG is New Residential's external manager. (A53 ¶ 40)

FOE I is alleged to be the sole managing member of FIG. (A53 ¶ 42) The general partner of FOE I is alleged to be FIG Corp. (*Id.*) Plaintiff alleges that FIG Corp. is a wholly-owned subsidiary of Fortress. (*Id.*)

Fortress is a "huge investment company" with approximately $67.5 billion in assets under management ("AUM"). (A54 ¶ 44) Plaintiff does not allege the amount of Fortress's revenue, profit, or any other financial metric for any year. Plaintiff alleges that "Fortress and its affiliates and principals" owned approximately 2.4 million shares of New Residential and 8.9 million options of New Residential as of December 31, 2014, amounting to 7.4% of New Residential's common stock on a fully diluted basis. (A59 ¶ 52)

B. FIG's Management And The New Residential Equity Plan.

The Management Agreement between FIG and New Residential at the time of the HLSS Acquisition makes clear that: "The Manager, in its capacity as manager of the assets and the day-to-day operations of the Company, at all times

will be subject to the supervision of the Company's Board of Directors…." (A592) Because New Residential has no employees, FIG's employees do all of the work for New Residential. (A42 ¶ 13) As the Management Agreement details, FIG, among other things, determines the criteria for New Residential investments; sources, analyzes and executes on investments and sales; and performs financial and accounting management. (*Id.*) In exchange, FIG is paid annual management fees, which are tied to the amount of AUM. FIG is also eligible to receive incentive compensation fees based on performance, but only if New Residential's investments surpass contractually specified returns. A substantial portion of FIG's management fees are incentive-based. (A74-75 ¶ 85)

FIG's compensation structure is detailed in the Management Agreement and the New Residential Investment Corp. Nonqualified Stock Option and Incentive Award Plan adopted on April 29, 2013 (the "Equity Plan"). (A588; A612) The Equity Plan discusses FIG's ability to receive New Residential stock incentive awards as compensation for its services:

> Grant of Compensatory Stock Options. As consideration for the Manager's role in raising capital for the Company, the Manager may be awarded Stock Options in connection with any equity issuance by the Company, to acquire that number of shares of Stock up to ten percent (10%) of the equity securities issued by the Company in such equity issuance, subject to the proviso contained in Section 5.5(f) below.

(A623) The Equity Plan is administered by New Residential's Compensation Committee, which has the discretion to issue options. (A624 § 5.5(f))

C. New Residential And HLSS Enter Into The Initial Merger.

HLSS was a publicly traded Cayman Islands exempted company that owned mortgage servicing rights ("MSRs"). (A35 ¶ 1, A82-83 ¶ 102) HLSS did not service mortgages, but instead relied on Ocwen Financial Corp. ("Ocwen") and another servicer for third-party residential mortgage loan services. (A82-83 ¶ 102) The First Amended Complaint alleges that "HLSS relie[d] heavily on Ocwen to achieve its investment objectives," and that HLSS's financial performance was strongly tied to Ocwen's performance. (A83 ¶ 103) Over the past several years, Ocwen has been "plagued by regulatory problems" (A85-86 ¶ 107), which impacted HLSS and HLSS's stock price (A83-84 ¶¶ 104-05).

On February 22, 2015, New Residential and HLSS entered into an Agreement and Plan of Merger wherein New Residential would acquire HLSS for $18.25 per share in cash (the "Initial Merger") – at least $5 per share less than HLSS's twelve-month high. (A89 ¶ 114) In view of the risks presented by HLSS's ongoing financial problems, New Residential negotiated for the right to terminate the Initial Merger if HLSS received a going concern qualification from its auditors for fiscal year 2014. (*Id.*)

D. HLSS And New Residential Terminate The Initial Merger And Enter Into An Asset Purchase Agreement.

On April 6, 2015, HLSS notified New Residential that HLSS was reasonably likely to receive a going concern qualification from its auditors. (A36-37 ¶ 3) Moreover, HLSS notified New Residential that if HLSS did not consummate the Initial Merger or enter into some alternative transaction with New Residential, it would increase the likelihood that HLSS would receive a going concern qualification, which, among other things, would result in a default under certain of HLSS's credit facilities. (*Id.* ¶ 116)

On April 6, 2015, New Residential and HLSS entered into a termination agreement that terminated the Initial Merger and mutually released all claims related to that agreement or the transactions contemplated by it. (A37 ¶ 4, A90-91 ¶ 116; A671-72 § 3(a))

On April 6, 2015, HLSS, New Residential, HLSS MSR-EBO Acquisitions LLC and HLSS Advances Acquisition Corp. entered into a Share and Asset Purchase Agreement (the "Purchase Agreement"). (A90-91 ¶ 116) Under the Purchase Agreement, HLSS received $1.007 billion in cash, plus 28,286,980 newly-issued shares of New Residential stock, in exchange for which New Residential purchased substantially all of HLSS's assets. (A91 ¶ 117) The Purchase Agreement provided that as soon as practicable, HLSS would sell the New Residential shares it received and distribute the proceeds from that sale,

together with its remaining cash (minus a $50 million reserve), to HLSS stockholders. (A92 ¶ 118) The HLSS Acquisition closed simultaneously with the signing of the Purchase Agreement.

Along with the execution of the Purchase Agreement, the HLSS board of directors approved a plan of complete liquidation and dissolution, pursuant to which HLSS would wind down operations, and distribute to its stockholders the cash received in the HLSS Acquisition and sale of New Residential stock. Also following the closing, HLSS entered into an Agreement and Plan of Merger with New Residential and Hexagon Merger Sub, Ltd., pursuant to which HLSS would be merged into Merger Sub, with Merger Sub as the surviving entity (the "Merger"). Upon the effective date of the Merger, each HLSS share would be converted into the right to receive $0.704059 per share in cash. (A92-93 ¶ 120) The Merger was subject to, among other things, approval by a vote of two-thirds of HLSS stockholders. On October 23, 2015, over two-thirds of HLSS stockholders voted in favor of the Merger, and the Merger was consummated. (A679-80)

E. New Residential Issues Equity And HLSS Sells The New Residential Equity It Received.

In connection with the HLSS Acquisition, HLSS entered into a Registration Rights Agreement with New Residential providing HLSS with certain customary registration rights with respect to the New Residential common stock issued to it. (A92 ¶¶ 118-19) Pursuant to an April 10, 2015 Prospectus Supplement, New

Residential offered to sell to the public 21,713,020 shares of its common stock, and, exercising its rights under the Registration Rights Agreement, HLSS offered for sale the 28,286,980 shares of New Residential common stock it received in the HLSS Acquisition. (A94-95 ¶ 123) The underwriters of the offering also exercised their option and sold an additional 7.5 million New Residential shares (with the sale by HLSS and New Residential, the "Offering"). (*Id.*)

Because the New Residential stock issued to pay for the HLSS Acquisition and sold in the Offering constituted an equity issuance, the Equity Plan authorized New Residential's Compensation Committee to consider whether to grant to FIG options to purchase up to 10% of the number of shares issued. The First Amended Complaint alleges that the New Residential Compensation Committee approved the issuance of options relating to 2,921,302 options at an exercise price per share equal to the Offering price. (A38-40 ¶¶ 7-8, A94-95 ¶¶ 123-24) This represented 10% of the total number of shares issued by New Residential in the Offering. (A94-95 ¶ 123) 2,828,698 options were also issued as a result of the issuance of New Residential shares to HLSS in the HLSS Acquisition, representing 10% of the New Residential shares issued to HLSS. (*Id.*) Plaintiff alleges that these options were issued to FOE I. (*Id.*)

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY DISMISSED THE FIRST AMENDED COMPLAINT.

A. Question Presented

In dismissing without prejudice Count II of the First Amended Complaint under Court of Chancery Rule 23.1, did the Court of Chancery correctly hold that directors who allegedly lacked independence from Fortress were not disabled from considering a demand unless Plaintiff alleged particularized facts showing that Fortress had a material conflict of interest with respect to the HLSS Acquisition, and that Plaintiff had failed to so plead? (First Op. at 31) As an alternative ground for affirmance, did the Court of Chancery err by holding that Plaintiff had alleged particularized facts creating a reasonable doubt as to the independence of Douglas Jacobs merely because he also served as an outside director of Fortress? (A279-80, A900; A1329-32)

B. Scope Of Review

This Court's "review of decisions of the Court of Chancery applying Rule 23.1 is *de novo*." *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

C. Merits Of Argument

1. Under Court Of Chancery Rule 23.1, Plaintiff Was Required To Plead Demand Futility.

A "cardinal precept" of Delaware law is "that directors, rather than shareholders, manage the business and affairs of the corporation." *Aronson*, 473 A.2d at 811. Accordingly, "[s]tockholders cannot shortcut the board's control over the corporation's litigation decisions without first complying with Court of Chancery Rule 23.1." *City of Birmingham Ret. & Relief Sys. v. Good*, 2017 WL 6397490, at *4 (Del. Dec. 15, 2017).

Under Rule 23.1, a stockholder must either make pre-suit demand on the board of directors to pursue the proposed claims, or demonstrate that such a demand is excused because it would be legally futile. Directors of a Delaware corporation "are entitled to a *presumption* that they were faithful to their fiduciary duties" and will comply with their duty in considering a demand. *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048-49 (Del. 2004). "[U]nder Rule 23.1, the plaintiffs have a heightened burden to plead particularized facts establishing a reasonable doubt that ... the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *City of Birmingham Ret. & Relief Sys.*, 2017 WL 6397490, at *5 (citations and quotations omitted). *See also In re Gen. Motors Co. Derivative Litig.*, 2015 WL 3958724, at *1 (Del. Ch. June 26, 2015) ("The

requirement that plaintiffs demonstrate futility is – must be – rigorous."), *aff'd*, 133 A.3d 971 (Del. 2016) (TABLE).

Specifically, to establish demand futility when challenging a board's affirmative act, a plaintiff must plead particularized facts in the complaint that create a reasonable doubt that either (1) a majority of the board members is disinterested and independent, or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. *Aronson*, 473 A.2d at 814.

Here, Plaintiff argued that the New Residential board lacked a majority that was independent from Fortress. The Court of Chancery held that Plaintiff had alleged particularized facts creating a reasonable doubt that three of the six directors (Edens, Nierenberg and Jacobs) were independent from Fortress. (First Op. at 26-27.) However, as Plaintiff concedes, a lack of independence does not disable a director from considering a demand unless the allegedly dominating person is itself conflicted. *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 357 (Del. Ch. 1998), *aff'd in part, rev'd in part*, *Brehm*, 746 A.2d 244. The Court therefore examined Plaintiff's allegations relating to Fortress. It concluded that Plaintiff did not "adequately allege that Fortress is materially interested in the challenged transactions," and that therefore demand was not excused. (First Op. at 27)

Plaintiff argues that the Court of Chancery erred in two respects. First, Plaintiff argues that even an immaterial interest on Fortress's part should have been sufficient to excuse demand because Fortress supposedly engaged in "self-dealing." Second, Plaintiff argues that it adequately pleaded that Fortress had a conflict of interest that was material to it. Plaintiff is wrong in both respects.

2. Plaintiff Was Required To Allege Facts Supporting A Reasonable Inference That Fortress Had A Material Conflict Of Interest.

When considering whether an alleged conflict of interest disables a director from considering a demand, Delaware law appropriately distinguishes between "self-dealing" transactions (where a fiduciary stands on both sides of a transaction and can set its terms), and transactions involving "side benefits" (where a fiduciary allegedly received a benefit from a transaction with a third-party that is not shared pro-rata with other stockholders).

If a fiduciary stands on both sides of the transaction, it has both the motive and ability to transfer wealth from one side to the other to the direct detriment of its beneficiaries. By contrast, where a fiduciary is alleged merely to have received a side benefit not shared with other stockholders, the presumption that the fiduciary complied with its duty will not be rebutted if the alleged side benefit is immaterial to the fiduciary. Thus, this Court has long recognized that "a plaintiff's burden of proof of a director's self-interest in an arms-length third-party transaction should

be greater than in a classic self-dealing transaction where a director or directors stand on both sides of a transaction." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 362 (Del. 1993). (*See* First Op. at 29 n.69 ("[T]he need to demonstrate materiality to establish the interest of a director in a transaction applies only 'in the absence of self-dealing' and that 'whenever a director stands on both sides of the challenged transaction he is deemed interested and allegations of materiality have not been required.'") (quoting *Cambridge Ret. Sys. v. Bosnjak*, 2014 WL 2930869, at *5 (Del. Ch. June 26, 2014), quoting *Orman v. Cullman*, 794 A.2d 5, 23, 25 n.50 (Del. Ch. 2002))) This makes perfect sense. Delaware law presumes that directors will do their duty; not just that they will do their duty only if they are otherwise completely indifferent. If the mere allegation that a fiduciary had received a side benefit, no matter how small, was sufficient to rebut the presumption that the fiduciary complied with her duty, then the presumption would be of little consequence.

Plaintiff says this distinction applies only to the ultimate burden of proof at trial and not to a pleading (AOB 30), but Plaintiff is wrong. Where a plaintiff alleges that a director suffers from a conflict of interest, our courts have consistently held that the director does not lose the presumption of compliance with duty at the pleading stage unless the alleged conflict is material to the director. *See, e.g.*, *RCS Creditor Trust v. Schorsch*, 2017 WL 5904716, at *14

(Del. Ch. Nov. 30, 2017) ("[I]n the absence of self-dealing, it is not enough to establish the interest of a corporate fiduciary by alleging that he received any benefit not equally shared by the stockholders. Such benefit must be alleged to be material to that fiduciary.") (emphasis, internal alterations, quotations and citations omitted); *In re Gen. Motors (Hughes) S'holder Litig.*, 2005 WL 1089021, at *8 (Del. Ch. May 4, 2005) (allegations of pecuniary self-interest must allow the court to infer that interest was sufficiently material, in the context of fiduciary's relevant economic circumstances, for fiduciary to act disloyally), *aff'd*, 897 A.2d 162 (Del. 2006); *Orman*, 794 A.2d at 23, 25 n.50 (a "disabling 'interest'" requires that the "benefit (or detriment) is of such subjective material significance to that particular director that it is reasonable to question whether that director objectively considered the advisability of the challenged transaction to the corporation and its shareholders"); *Jacobs v. Yang*, 2004 WL 1728521, at *6 (Del. Ch. Aug. 2, 2004) ("[T]he facts alleged do not give rise to the inference that the value of these contracts was material to Activision or Macromedia."), *aff'd*, 867 A.2d 902 (TABLE).

Moreover, this materiality requirement applies not only to directors themselves (when the directors are alleged to have a conflict of interest), but to allegedly dominating persons (from whom the directors are alleged to lack independence). *See Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1168

(Del. 1995) (director independence inquiry is whether a director with a "material self-interest" controls or dominates the board); *Khanna v. McMinn*, 2006 WL 1388744, at *17 (Del. Ch. May 9, 2006) ("Ultimately, the inquiry into independence turns in this instance on whether Covad's business relationship with BEA Systems was material to BEA or to [the director] himself as a director of BEA."); *Orman*, 794 A.2d at 22 (evaluating whether "'a majority of the director defendants have a financial interest in the transaction or were dominated or controlled by a materially interested director'") (citation omitted); *Friedman v. Beningson*, 1995 WL 716762, at *4 (Del. Ch. Dec. 4, 1995) (analyzing whether a majority of directors were "under the control, domination or strong influence of a party with a material financial interest in the transaction under attack, which interest is adverse to that of the corporation"); *accord In re Books-A-Million, Inc. Stockholders Litig.*, 2016 WL 5874974, at *9 n.4 (Del. Ch. Oct. 10, 2016) (quoting *Friedman*), *aff'd*, 164 A.3d 56 (TABLE); *Huff Energy Fund, L.P. v. Gershen*, 2016 WL 5462958, at *11 (Del. Ch. Sept. 29, 2016) (quoting *Orman*); *In re Crimson Expl. Inc. Stockholder Litig.*, 2014 WL 5449419, at *20 (Del. Ch. Oct. 24, 2014) (quoting *Orman*). Again, this makes perfect sense, because if Delaware law presumes (as it does) that a director would not breach her duty for an immaterial *self*-interest, there is even less reason to presume the director would breach her duty for the immaterial interest of another.

Here, the Court of Chancery noted that Plaintiff did not allege any connection between Fortress and HLSS and held that "[t]his is not a case of self-dealing where the materiality requirement does not apply…. Rather, the HLSS acquisition was a third-party transaction between New Residential and HLSS in which Fortress allegedly received a special side benefit." (First Op. at 29 n.69)

Plaintiff first criticizes the Court of Chancery because there was "no substantive factual or legal analysis" of its holding that Plaintiff did not allege self-dealing (AOB 23) – but Plaintiff did not contend otherwise. As the Court of Chancery observed in denying reargument, Plaintiff conceded that it "did not address the distinction between self-dealing and side benefit transactions in its briefs or at oral argument" on the motion to dismiss. (Second Op. at 4-5) Thus, Plaintiff did not preserve this argument for appeal and it is thereby waived. *See* Supr. Ct. R. 8; *In re Infinity Broad. Corp. S'holders Litig.*, 802 A.2d 285, 289 (Del. 2002) ("This Court generally will not address the merits of any issue not presented to the trial court," and finding appellee waived argument on appeal when it "did not pursue the issue" at hearing below).

Plaintiff's argument on appeal is no better than the absence-of-argument it offered below. Plaintiff does not attempt to argue that Fortress stood on the HLSS side of the transaction. Nor could it, since the only "dealing" here was between New Residential and HLSS; there was no "dealing" at all between New Residential

and Fortress, let alone "*self*-dealing." Instead, Plaintiff appears to argue that New Residential's acquisition of HLSS's assets was "self-dealing" simply because Fortress allegedly benefitted from it in ways not shared by other stockholders. (AOB 24-25) That is precisely what our law means in distinguishing between "side benefit" and "self-dealing." Even if the person allegedly receiving the "side benefit" is a controller (which is not the case here), receipt of non-pro rata consideration does not turn a third-party transaction into self-dealing. *Se. Pa. Transp. Auth. v. Volgenau*, 2013 WL 4009193, at *12 (Del. Ch. Aug. 5, 2013) ("[W]hen a corporation with a controlling stockholder merges with an unaffiliated company, the minority stockholders of the controlled corporation are cashed-out, and the controlling stockholder receives a minority interest in the surviving corporation, the controlling stockholder does not 'stand on both sides' of the merger."), *aff'd*, 91 A.3d 562 (Del. 2014) (TABLE).

Plaintiff does not offer the Court any case in which acquisition of assets from a third-party was held to be self-dealing. By contrast, cases involving allegations that transactions with third parties were structured to benefit insiders – as Plaintiff alleges here – have consistently been treated as "side benefit" cases subject to a materiality requirement. *See*, *e.g.*, *RCS Creditor Trust*, 2017 WL 5904716, at *14 (discussing third-party acquisition in which controller received

benefits as a side benefit, not self-dealing, transaction, and engaging in materiality inquiry).

Plaintiff says that the only case it relies upon, *Kahn v. Portnoy*, is "instructive." (AOB 26) It certainly is. It instructs that Plaintiff is wrong. *Kahn v. Portnoy* involved a lease between a landlord and a tenant, both of whom were affiliated with the same entity, RMR. 2008 WL 5197164, at *3 (Del. Ch. Dec. 11, 2008). Unsurprisingly, the Court held that RMR and directors affiliated with RMR stood on "both sides" of the transaction – because they did. *Id*. at *12. Here, in stark contrast, no one affiliated with Fortress or New Residential is alleged to have stood on the HLSS side of the transaction.

The Court of Chancery's recent opinion in *RCS Creditor Trust v. Schorsch,* which Plaintiff cites approvingly, further proves the point. (AOB 24 n.20) There, the plaintiff alleged that the controller defendants forced RCAP to acquire third parties in several disastrous transactions, and that the acquisitions were solely undertaken to benefit RCAP's manager, AR Capital (which was 100% owned by RCAP's controllers), not RCAP. 2017 WL 5904716, at *14. The Court of Chancery determined the acquisitions were not self-dealing transactions in which a fiduciary stood on both sides, even though they were allegedly undertaken to benefit the controller's wholly-owned subsidiary. *Id.* ("The Control Defendants did not stand on both sides of these acquisitions, but the deals were allegedly

pursued because they would benefit AR Capital, not RCAP.”). Therefore, the Court required the plaintiffs to allege facts demonstrating that the benefits to the controller were material – exactly as Plaintiff was required, and failed, to do here.[2] As the Court in *RCS* explained: “Because the Control Defendants did not stand on both sides of the challenged acquisitions … they do not involve the kind of evident self-dealing that of itself triggers entire fairness review. Instead, the Plaintiff’s theory is that the Control Defendants received financial benefits from these decisions that were not shared with RCAP’s other stockholders. … But ‘in the absence of self-dealing, it is not enough to establish the interest of a corporate fiduciary by alleging that he received *any* benefit not equally shared by the stockholders. Such benefit must be alleged to be *material* to that fiduciary.’” *Id.* at *14 (internal alterations omitted) (quoting *Orman*, 794 A.2d at 23).

In *RCS*, the plaintiff’s attack on the acquisitions “suffer[ed] from a fatal flaw,” because “[t]he Complaint lacks any facts suggesting that the benefits these decisions provided to the Control Defendants were material to them.” *Id.* at *15. The Court thus concluded: “I must dismiss those causes of action where the Defendants do not appear on both sides of the transaction. … [T]o survive a motion to dismiss in these circumstances, based on allegations that the Control

[2] *RCS*’s rationale is even more compelling here because the entity that was alleged to have received the side benefit was a controller and therefore a fiduciary. Here, Fortress does not control New Residential.

Defendants received an ancillary benefit not shared by all stockholders, requires pleading that the benefit was sufficiently material to overcome fiduciary duties. Otherwise, *every* business decision taken by the Control Defendants would be subject to entire fairness review. That is not our law. … These decisions therefore receive the protection of the business judgment rule ….” *Id.* at *16

3. Plaintiff Did Not Adequately Allege That Fortress Had A Material Conflict Of Interest.

(a) Plaintiff's allegations do not support a reasonable inference that Fortress or New Residential's directors would benefit by causing New Residential to overpay for HLSS.

Having correctly determined that demand was not excused unless Plaintiff alleged that Fortress suffered from a material conflict of interest, the Court of Chancery then correctly found that Plaintiff had not alleged facts showing that any side benefit to Fortress was material to it – indeed, Plaintiff had not even *argued* that Fortress's alleged interest was material to it. The Court also correctly noted that, even if Fortress had received a side benefit from the HLSS Acquisition, that did not explain why Fortress or New Residential's directors would have had an incentive to cause New Residential to *overpay* for HLSS. (First. Op. at 31; *see also* A282-84)

On appeal, Plaintiff contends various ways in which the HLSS Acquisition benefitted Fortress or Fortress affiliates. Plaintiff is wrong, both because none of

the alleged benefits would have incentivized Fortress to attempt to cause New Residential to overpay for HLSS's assets, and because none of those benefits are alleged to have been material to Fortress.

To begin, Plaintiff's allegations show that the structure of Fortress's economic relationship with New Residential powerfully aligns Fortress's interests with the best interests of New Residential and its stockholders. When applying Rule 23.1 and considering whether a plaintiff has alleged particularized facts raising a reasonable doubt as to a director's disinterest and independence, Delaware courts take into account allegations showing that a fiduciary's self-interest was actually aligned with the interests of its beneficiaries.

For example, in *In re Walt Disney Co. Derivative Litigation*, the Court of Chancery considered not only the argument that Eisner, Disney's CEO, caused the company to maximize payments to another officer in order to raise the bar for his own compensation, but also considered Eisner's substantial economic interest in Disney, and held that "Plaintiffs' allegation that Eisner was interested in maximizing his compensation at the expense of Disney and its shareholders cannot reasonably be inferred from the facts alleged in Plaintiffs' amended complaint. At all [material] times … Eisner owned several million options to purchase Disney stock. Therefore, it would not be in Eisner's economic interest to cause the Company to issue millions of additional options unnecessarily and at considerable

cost." 731 A.2d at 355. *See also In re Dow Chem. Co. Derivative Litig.*, 2010 WL 66769, at *8 (Del. Ch. Jan. 11, 2010) (finding demand not excused where director depended on company for her livelihood, "[h]er interests are aligned with the company and presumably she is able to make decisions in the best interests of the company"); *Desimone v. Barrows*, 924 A.2d 908, 946 (Del. Ch. 2007) (finding demand not excused where board members, who owned nearly a third of the corporation's stock, had no incentive to spring load options because "[a]ny undue enrichment of [the option recipients] would have come largely at [the stockholder directors'] own expense"); *In re Oracle Corp. Derivative Litig.*, 867 A.2d 904, 930 (Del. Ch. 2004) (that corporate fiduciaries have "'skin in the game' [which] will tend to align their interests with those of the public stockholders" is a "good idea") (citations omitted), *aff'd*, 872 A.2d 960 (Del. 2005) (TABLE).

Here, although FIG earned a relatively small base management fee tied simply to the size of New Residential, Plaintiff alleges that base annual management fee was just $19.7 million, compared to $74 million in total fees and compensation. (A97-98 ¶¶ 130-31) Thus, the majority of its compensation came from incentive fees and stock options.

As Plaintiff notes, the Management Agreement provides for "FIG' s incentive compensation [of] 25% of New Residential's income above a 10% annual return." (AOB 25-26) As the Court also noted, that structure aligned

Fortress's interest with that of other stockholders by offering Fortress (via FIG) "significant upside potential if the HLSS acquisition is successful." (AOB 26) By contrast, overpaying for HLSS's assets would drive down stockholder returns and jeopardize FIG's incentive fee. Indeed, directly contrary to Plaintiff's argument, Fortress would have been particularly motivated to avoid New Residential overpaying for assets by issuing equity, because equity issuances increased the denominator on which New Residential had to earn a 10% return before FIG would receive any incentive compensation.

The bottom line is that Fortress's pre-existing New Residential equity position, together with the incentive fee structure in the Management Agreement, gave Fortress more reason than anyone to want New Residential to buy HLSS's assets only if it increased New Residential's value, and only as cheaply as possible.

Unable to rebut that reality, Plaintiff tries to argue that Fortress had an idiosyncratic appetite for risk because it would reap the upside from a successful acquisition, but in the event the deal turned out poorly, Fortress could supposedly take steps (never alleged or argued below) to "circumvent any decline" so that "the real cost of a bad deal" would fall on "other stockholders." (AOB 26) But Plaintiff's argument proves too much. The steps that Plaintiff speculates Fortress could take to "circumvent any decline" – *i.e.*, causing New Residential to recharacterize HLSS income and designating items as Non-Routine to increase

FIG's incentive compensation – are not steps that would only arise in the event the acquisition turned out poorly. Plaintiff's argument presumes that Fortress controls New Residential and can cook the books to give itself more money any time it wishes.[3] Even if that were true, and it most certainly is not, why would Fortress only do that to "circumvent any decline"? Why not do it regardless? Why not buy HLSS's assets at the best possible price and then cook the books to make it even better?

In sum, if New Residential overpaid for HLSS and thereby diminished the value of New Residential, Fortress's significant equity interest, FIG's existing and new options and its prospects for incentive compensation would be worth less, not more. Thus, Plaintiff's argument is wrong because it would require the illogical inference that Fortress pushed through the HLSS Acquisition "against [its] self-

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[3] Plaintiff repeatedly asserts that Fortress "controlled" New Residential. (AOB 1, 5, 21) The Court of Chancery expressed "serious doubts that Fortress exercises control over New Residential in light of *In re KKR Fin. Hldgs. LLC S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014)," but found it "need not decide that issue." (First Op. at 19-20 n.40) To the extent relevant, this Court should follow the Court of Chancery's reasoning and find that Fortress is not a controlling stockholder of New Residential because it neither owns a majority of New Residential voting power nor exercises "actual control" over New Residential and thus owes no fiduciary duties. *Binks v. DSL.net, Inc.*, 2010 WL 1713629, at *11 (Del. Ch. Apr. 29, 2010) ("A shareholder does not owe fiduciary duties to the company's other shareholders unless 'it owns a majority interest or *exercises control* over the business affairs of the corporation.'") (citation omitted).

interested incentives as [a] stockholder[] to maximize value." *In re Crimson Expl. Inc.*, 2014 WL 5449419, at *17.

Ultimately, Plaintiff's argument is simply that because New Residential is externally managed and pays FIG in part based on the size of New Residential's AUM, New Residential cannot acquire assets without being subject to litigation. That is not the law.

(b) Plaintiff failed to allege that any interest Fortress had in the HLSS Acquisition was material to it.

Even if one ignores the substantial ways in which Fortress and its affiliates stood to suffer if New Residential overpaid for HLSS's assets, Plaintiff still has not met its pleading burden because it does not allege facts supporting an inference that any side benefit to Fortress from the HLSS Acquisition was material to Fortress. The Court of Chancery held that the First Amended Complaint did not allege sufficient facts demonstrating that Fortress had a material interest in the HLSS Acquisition. (First Op. at 30-31)

In particular, other than the allegation that Fortress was "huge" and had $67 billion under management, Plaintiff did not make a single allegation about the size or financial metrics of Fortress that the Court of Chancery could use as a "denominator" in attempting to determine whether any purported benefit to Fortress might be material to it. (*See, e.g.*, Second Op. at 6-7) On its motion for

reargument, Plaintiff asked the Court of Chancery to find relevant figures in public filings that had been referred to in the First Amended Complaint, but the Court held that "it is not the responsibility of this Court to parse through hundreds of pages of public filings that Plaintiff cites sparingly in search of relevant facts that Plaintiff should have pled in its Complaint (and could plead in a further amended complaint)." (*Id.* at 8-9) Plaintiff does not argue that this was erroneous, and this holding should be affirmed. Plaintiff cannot now rely on facts it did not allege merely because they are included in New Residential's voluminous public filings; but even if it could so rely, it would not have shown materiality.

As the Court of Chancery recognized when denying Plaintiff's motion for reargument, Plaintiff did not respond to Defendants' arguments in briefing or oral argument on the First Amended Complaint that the benefits Fortress allegedly received from the HLSS Acquisition were immaterial. (Second Op. at 9 ("Defendants raised the issue of materiality in their opening brief in support of their motion to dismiss and at oral argument. ***But Plaintiff did not respond to that argument***.") (emphasis added)) Plaintiff cannot now raise such arguments. *See In re Infinity Broad. Corp.*, 802 A.2d at 289.

Even if this Court permitted Plaintiff to rely on arguments it never raised below, the Court should still affirm because Plaintiff did not adequately plead that any benefits Fortress received were material to it.

Plaintiff claims that Fortress's primary interest in New Residential is to extract fees and compensation for its affiliates. (A61-62 ¶ 56) Plaintiff alleges that Fortress is therefore interested in the HLSS Acquisition because Fortress allegedly received $100 million dollars as a result, because (1) the acquisition resulted in New Residential having more assets, which increased FIG's management fee by $6.5 million (A98 ¶ 131; AOB 19); (2) the acquisition caused FIG's management fees to increase by $43.8 million because New Residential recharacterized a portion of HLSS's historical income (A41 ¶ 10; AOB 19-20); and (3) Fortress (via FIG and FOE I) received "$57 million from [] option exercises and stock sales" (AOB 20).

However, like many of Plaintiff's arguments on appeal, this allegation was not in Plaintiff's First Amended Complaint, nor did Plaintiff make this argument in connection with the First Opinion. (Second Op. at 6 n.19 ("Plaintiff argues that Fortress received a $100 million benefit from the challenged transactions over a six-month period. … The $100 million figure does not appear in Plaintiff's briefs or complaint, and Plaintiff has not explained why it added the numbers that it did to reach the $100 million."); *see also id.* at 8 n.26 ("Plaintiff's motion for reargument relies on numbers in the Fortress public filings that did not appear in the Amended Complaint or Plaintiff's opposition brief."))

But even if the Court considers this $100 million argument, the First Amended Complaint offers no basis reasonably to infer that any of the purported components of that number are material to Fortress. As an initial matter, as the Court of Chancery found, Plaintiff did not allege with particularity the nature of the relationship between FIG, FOE I, and Fortress, the entities that received these benefits, sufficient to determine that Fortress was the ultimate beneficiary. (First Op. at 30 ("[T]he Complaint does not allege anything regarding the percentage of Fortress's ownership of FOE I, through FIG Corp., or the ratio of the alleged benefits to any Fortress financial metric.")) But even if Plaintiff had sufficiently alleged that Fortress itself received the alleged benefits, as discussed herein, because Plaintiff alleged no particularized facts about Fortress's size or financial performance, the Court cannot draw a reasonable inference of materiality. First Op. at 30 ("Plaintiff has not alleged that the challenged business practices (or these types of transactions) are material to Fortress taken together.").

First, as for the $6.5 million increase in FIG's management fees, Plaintiff ignores the central fact that New Residential has no employees of its own, and that FIG's management fees compensate it for work of FIG's employees (paid by FIG) that would otherwise have to be done by New Residential employees (paid by New Residential). (A286-87) Obviously an increase in New Residential's AUM increases the amount of work to manage those assets. Plaintiff does not allege any

particularized facts supporting a reasonable inference that an increase in FIG's management fees in exchange for being required to manage more assets was actually a benefit to FIG. (*Id.*) Merely alleging that FIG will get paid more money to do more work does not support an inference that Fortress was interested – let alone materially interested.

Moreover, even if one unreasonably assumed that the entire $6.5 million increase dropped to Fortress's bottom line, Plaintiff did not allege facts from which it could reasonably be inferred that that increase would be material to an entity as "huge" as Fortress. Not until its Second Amended Complaint did Plaintiff allege anything about FIG or Fortress's overall revenue, so the Court of Chancery was simply unable to draw an inference that $6.5 million would be material to Fortress.

Second, Plaintiff's argument that FIG received $43.8 million from an accounting recharacterization of HLSS's income is not supported by the facts alleged in the First Amended Complaint and documents incorporated by reference. (AOB 18) As Plaintiff conceded at argument below (A5126-27), the recharacterization Plaintiff complains about was merely an accounting adjustment to HLSS's historical financials in connection with the preparation of *pro forma* financial statements for the combined company – *not* a payment. (A287; A1706; A4945-46) The recharacterized HLSS income was for a period *predating* New Residential's ownership of the assets, and so "[t]he recharacterization ha[d] no

impact on the Company's audited historical financial information" or on FIG's incentive compensation because FIG received no payment as a result. (A1706) Fees that FIG never received cannot be material to Fortress.

Third, Plaintiff claims that Fortress is "interested" in the HLSS Acquisition because an "affiliate" of Fortress (FOE I) received 5.75 million options in the Offering. (A39-40 ¶ 8) However, the allegation that a Fortress affiliate received options in the Offering (a right which arose out of the Equity Plan) does not render Fortress interested in the HLSS Acquisition. Plaintiff does not allege that Fortress benefited from the issuance of options to FOE I. A Fortress subsidiary is general partner of FOE I, but Plaintiff does not allege what, if any, economic interest accompanies that general partner interest. This non-particularized pleading is insufficient to support an inference that Fortress was materially interested in the HLSS Acquisition based on issuance of options to FOE I. (*See* First Op. at 30-31)

Even if it were interested, Plaintiff has not demonstrated that Fortress got a net benefit from options received in exchange for the work it did raising capital for New Residential. As discussed above, New Residential has no employees, and could not have undertaken the Offering on its own. The options were awarded as "compensation for [FIG]'s role in raising capital" through the Offering, and "[t]he main purpose of these options is to provide transaction-specific compensation to [FIG], in a form that aligns [FIG's] interests with those of [New Residential]

stockholders, for the valuable services it provides in raising capital for [New Residential] to invest through equity offerings." (A289 (quoting A655)) Plaintiff has not alleged that the value of the options was disproportionate to the value of the work performed by FIG in connection with the Offering.

And, importantly, Plaintiff's argument ignores that FIG can receive – and had been receiving – incentive income only on equity returns exceeding 10% of book value. (A74-75 ¶ 85; A266; A1703) Thus, FIG would have been incentivized to protect that incentive income by financing the HLSS Acquisition with debt if it actually thought that the return on the new equity would have been low enough to push overall returns below the incentive threshold. And in any event, because Plaintiff made no particularized allegations about Fortress's size or level of financial performance, it failed to create a reasonable inference that the options were material to Fortress.

Moreover, the fact that Fortress holds significant shares and options in New Residential directly undermines any reason why Fortress would want New Residential to overpay for HLSS. Plaintiff alleges that Fortress owned approximately 7.4% of the equity of New Residential, comprised of 2.4 million shares of New Residential and 8.9 million options. (A59 ¶ 52; First Op. at 4) But if the HLSS Acquisition were a bad deal, New Residential's stock price would drop and, not only would FOE I's new options never be in the money, the value of

Fortress's existing options and New Residential shares would decline. The concept that Fortress forced New Residential to engage in the HLSS Acquisition, which would lead New Residential to conduct an equity offering, just so a Fortress affiliate could potentially receive options, is equally nonsensical – not just because, according to Plaintiff, Fortress would push a transaction in order to obtain options that it knew would be worthless, but because it would not have been required to tie an equity offering to the acquisition of HLSS. The Equity Plan provides that FIG *may* be issued options worth 10% of *any* equity offering. Plaintiff's argument once again proves too much. If Fortress allegedly controlled New Residential, and wanted FIG or an affiliate to receive options, Fortress could have forced New Residential simply to complete an equity offering. There would be no need to cause New Residential to waste millions of dollars overpaying on an asset purchase. This is not a case where a party with a vastly larger voting stake compared to its equity stake would have an incentive to take action that would harm other stockholders. As the Court stated in the First Opinion:

> Plaintiff [] fails to adequately allege how the New Residential directors were incentivized to overpay for HLSS. Plaintiff argues that the increased Management Fee and options rendered Fortress interested. The incentive compensation under the Management Agreement, however, appears to limit any incentive to overpay because FIG's incentive compensation depends on the percent return New Residential can earn on the book value of equity. Plaintiff should allege the amount by which New Residential allegedly overpaid, and Plaintiff's allegations should deal with the overpayment incentives so the

> Court can analyze the effects of the challenged transactions in the aggregate.

(First Op. at 31) Plaintiff did not do so.

Fourth, Plaintiff claims that Fortress hypothetically could receive up to $500 million in benefits from the HLSS Acquisition, and that this must be material to Fortress because $500 million could buy a very large house. (AOB 1, 34) Plaintiff arrives at this conclusion by claiming the HLSS Acquisition increased the amount of New Residential outstanding equity, thereby increasing Fortress's overall AUM, and that Fortress's business plan for its private equity business supposedly is dependent on increasing AUM. (*Id.*) But, as the Court of Chancery found, while capital raises are a part of Fortress's business model, Plaintiff does not allege that the increase in AUM as a result of the HLSS Acquisition was anything more than a beneficial coincidence. (First Op. at 30 ("Allegations that some of the effects of the challenged transactions benefited Fortress alone are not enough."))

Plaintiff also claims that the increase in AUM as a result of the HLSS Acquisition must be material because Fortress "advertised to its stockholders that $1.3 billion of new equity would generate approximately $500 million in management fees and incentive income." (AOB 36)[4] But this $500 million

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[4] Plaintiff alleges that Fortress had $67.5 billion in AUM, but Plaintiff did not allege what percentage of Fortress's total AUM New Residential represented, or the percentage increase of Fortress's total AUM as a result of the HLSS Acquisition. (*See* Second Op. at 7)

number is drawn from a Fortress presentation where Fortress provided a general example (totally unrelated to New Residential) of how a $1 billion increase in the capital of a Fortress permanent capital vehicle might, *over its lifetime*, produce management and incentive fees of $375 to $425 million in the aggregate to Fortress. (Plaintiff could not tell the Court of Chancery over what period of time the hypothetical additional $500 million was supposedly to be earned. (A5117-18)) These figures were *not* the results Fortress forecast from any particular capital raise, they had no relationship to New Residential, and they certainly were not suggestive of any single-year revenues. (A1675) Even Plaintiff is now forced to admit: "*This is not an apples-to apples comparison*." (AOB 36 (emphasis added)) Thus, Plaintiff's headline argument that Fortress somehow received $500 million as a result of the HLSS Acquisition is unsupported speculation, and insufficient to demonstrate that Fortress had a material interest in the transaction.

For these reasons, Plaintiff has failed to demonstrate that Fortress received material benefits through the HLSS Acquisition that would render Fortress interested, and the Court of Chancery's holding should be affirmed.

4. A Majority Of The New Residential Board Is Disinterested And Independent.

Even if this Court concludes that the Court of Chancery erred in analyzing the allegations regarding Fortress, it should still affirm the dismissal because the Court of Chancery improperly concluded that Plaintiff's allegations supported an

inference that half of the board lacked independence from Fortress. Critically, the Court of Chancery erred in concluding that Douglas Jacobs lacked independence because he served as an independent director of Fortress.

Under the first prong of *Aronson*,[5] Plaintiff bears the burden of alleging with particularity facts sufficient to create a reasonable doubt that a majority of "the directors are disinterested and independent." 473 A.2d at 814. The Court of Chancery held that Plaintiff had alleged sufficient particularized facts to create a reasonable doubt that defendants Wesley Edens, Michael Nierenberg and Douglas Jacobs could act independently of Fortress. (First Op. at 25) As to Mr. Jacobs, the Court of Chancery erred.

Plaintiff alleges that Mr. Jacobs is an outside director of Fortress. (A42 ¶ 13) Grouping him together with Defendants Edens and Nierenberg who are, respectively, a principal of Fortress and employee of Fortress, the Court held that Mr. Jacobs "owe[s] fiduciary duties to both companies and [is] considered conflicted in board decisions regarding dealings between New Residential and Fortress." (First Op. at 26, citing *Parfi Holding AB v. Mirror Image Internet, Inc.* 794 A.2d 1211, 1230-31 (Del. Ch. 2001), *rev'd on other grounds*, 817 A.2d 149 (Del. 2002)) That holding is contrary to this Court's precedent.

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[5] Plaintiff does not argue on appeal that demand is futile under the second prong of *Aronson*.

Mr. Jacobs is not alleged to have a financial interest in Fortress, but simply to be an outside director. The Court of Chancery found Mr. Jacobs's fiduciary duty to Fortress to be in potential conflict with Mr. Jacobs's fiduciary duty to New Residential. But that potential conflict only arises because of the Court of Chancery's erroneously broad conception of Mr. Jacobs's fiduciary duty to Fortress.

Joining the board of a Delaware corporation does not mean that a director must now devote her life to service of the beneficiary. Rather, a fiduciary's duty applies only when she is acting as a fiduciary, managing or exercising power over the beneficiary's property. *Cf. Odyssey Partners, L.P. v. Fleming Cos.*, 735 A.2d 386, 415 (Del. Ch. 1999) (when a controlling stockholder is "not acting in a fiduciary capacity," its conduct "is not subject to a fiduciary duty analysis").

Here, when considering and voting on the HLSS Acquisition as a New Residential director (or, hypothetically, when considering a demand to cause New Residential to sue Fortress), Mr. Jacobs is not exercising power as a Fortress fiduciary and therefore owes no duty to Fortress. As a result, he did not suffer from any conflict of duty and was free to consider only New Residential's interests.

Accordingly, this Court has held that a "claim of interlocking directorships," does not raise "a reasonable doubt as to the board's independence." *Heineman v.*

Datapoint Corp., 611 A.2d 950, 955 (Del. 1992); *accord Hartsel v. Vanguard Grp., Inc.*, 2011 WL 2421003, at *22 (Del. Ch. June 15, 2011) ("[S]ervice on multiple boards alone is insufficient to cast reasonable doubt on a [director]'s ability to exercise his business judgment as to whether to accept a stockholder's demand to bring suit…."), *aff'd*, 38 A.3d 1254 (Del. 2012) (TABLE).

In *Heineman*, Datapoint, a corporation engaged in computer manufacturing and software, paid United Stockyards for consulting services even though United Stockyards had no expertise in computers. 611 A.2d at 954-55. This Court found that the plaintiff did not adequately plead demand futility for a derivative claim challenging this transaction even though a majority of the Datapoint board also served on the board of United Stockyards, and Edelman, the leader of that group of directors, was both the chairman of Datapoint and the controlling stockholder of United Stockyards. *Id.* at 955.

Moreover, the concept that a director cannot consider a demand to sue another company because that director also serves on the board of that company was squarely rejected by the Court of Chancery and affirmed on appeal by this Court after *Parfi*. In *Hartsel*, plaintiffs alleged that a demand on the trustees of the nominal defendant, certain Vanguard funds, to sue Vanguard Group would be futile because the trustees also served as outside directors on Vanguard Group's board. 2011 WL 2421003, at *23. The Court of Chancery noted that the *Hartsel*

complaint "did not allege that one Trustee dominated the others or that the Trustees collectively were dominated by any other Defendant," and failed to plead facts suggesting that the trustees were interested in challenged transactions or that any trustee had received a benefit not shared with the funds and their stockholders. *Id.* at *24. Rather, the plaintiffs alleged only that "a demand by Plaintiffs essentially would ask [the interlocking directors] to sue themselves in their capacity as Vanguard directors." *Id.*

As the Court in *Hartsel* recognized, Plaintiff's position here amounts to nothing more than a rehash of the familiar argument rejected long ago: "Delaware law does not excuse demand on grounds of self-interest when a plaintiff's argument essentially boils down to a claim that director defendants generally are not inclined to sue themselves." *Id.*

Under this Court's precedent, Mr. Jacobs is independent of Fortress for purposes of demand futility. Because Plaintiff has not alleged particularized facts demonstrating that a majority of the New Residential board is not disinterested or lacks independence, Plaintiff has failed to plead that demand is excused and the Court of Chancery's judgment that Plaintiff failed to comply with Rule 23.1 should be affirmed on this alternative ground.

Additionally, even if this Court concludes that the Court of Chancery erred in dismissing Count II under Rule 23.1, it should remand for consideration of Defendants' arguments for dismissal under Rule 12(b)(6).

5. The Court Of Chancery Correctly Dismissed Count III.

The Court of Chancery dismissed the various declaratory judgment claims asserted in Count III of the First Amended Complaint as unripe, with one exception. (First Op. at 35) Plaintiff withdrew the only portion of Count III that had survived dismissal in its Second Amended Complaint. Plaintiff does not present any argument explaining why the Court of Chancery's dismissal of Count III was erroneous. Accordingly, that judgment should be affirmed.

CONCLUSION

For all of the foregoing reasons, the judgment below should be affirmed.

Respectfully submitted,

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