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IN THE SUPREME COURT OF THE STATE OF DELAWARE

CHESTER COUNTY EMPLOYEES' RETIREMENT FUND, Plaintiff-Below/ Appellant, v. 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, Defendants-Below/ Appellees.	)	No. 457, 2017 CASE BELOW: Court of Chancery of the State of Delaware C.A. No. 11058-VCMR

APPELLANT'S REPLY BRIEF

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I. PLAINTIFF SUFFICIENTLY PLEADS DEMAND FUTILITY UNDER THE FIRST PRONG OF *ARONSON*[1]

Plaintiff[2] appeals from the Court of Chancery's dismissal of the First Amended Complaint because Plaintiff sufficiently pleads demand futility under the first prong of *Aronson*. Plaintiff "fairly presented" to the court below the arguments set forth in its opening brief and this reply brief, thereby preserving the arguments for appeal.[3] Specifically, Plaintiff argued that demand upon the New Residential Board is excused because at least half of the Board is beholden to Fortress and either (i) the HLSS acquisition was a self-dealing transaction, A858-61, 1373-77, 1393-94; or (ii) Fortress had a material interest in the HLSS acquisition, A858-61, 1353, 1377, 1394-99, 4798-806.

A. Plaintiff's Particularized Allegations Support the Reasonable Inference that Fortress Engaged in Self-Dealing

The court below erred by requiring Plaintiff to plead that Fortress's financial interest in the HLSS acquisition was material to Fortress. AOB at 23-29. "[W]here self-dealing is present, a plaintiff need not plead that a director's interest in a challenged transaction is material to him to establish that the director has a disabling

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[1] *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

[2] Capitalized terms not otherwise defined herein have the same meaning set forth in Appellant's Corrected Opening Brief (hereinafter, "AOB").

[3] Del. Supr. Ct. R. 8.

interest."[4] Though the lower court and the defendants acknowledge this legal tenet, they seek to unduly limit the scope of self-dealing transactions under Delaware law. By summarily decreeing that Fortress received side benefits from this third-party transaction, the court below implicitly found, and the defendants advance the notion, that no fiduciary can engage in self-dealing nor stand on both sides of a third-party transaction unless that fiduciary is a party to the deal. *See, e.g.*, AOB at Ex. A, First Op. at n.69; Appellant's Answering Brief (hereinafter, "AAB") at 17. Neither the court below, nor the defendants cite any precedent to support their view because it is not, and should not become, the law.

1. Fortress Engaged in Self-Dealing and Stood on Both Sides of the HLSS Acquisition

Self-dealing occurs when a fiduciary causes a company to act in such a way that the fiduciary receives something "to the exclusion of, and detriment to," the stockholders whose interests the fiduciary is supposed to serve.[5] The hallmark of self-dealing is the unequal sharing of benefits and detriments between fiduciaries and stockholders, regardless of the materiality of the benefit to the fiduciaries.[6]

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[4] *Cambridge Ret. Sys. v. Bosnjak*, 2014 WL 2930869, at *4 (Del. Ch. June 26, 2014).

[5] *See Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

[6] *Cf. id*. at 721-22 ("Sinclair received nothing from Sinven to the exclusion of its minority stockholders. As such, these dividends were not self-dealing.").

This Court has expressly acknowledged that a fiduciary can engage in self-dealing even when it is not a party to the challenged transaction.[7] The *Aronson* Court explained that a disinterested director "can ***neither*** appear on both sides of the transactions ***nor*** expect to derive any personal financial benefit from it in the sense of self-dealing."[8] This disjunctive phrasing makes clear that this Court never intended to limit self-dealing to situations where a fiduciary is party to a transaction with the company the fiduciary serves.[9] This, however, is the logical extension of the lower court's decision and the defendants' arguments here.

A fiduciary also need not be a party to a transaction in order to stand on both sides of it. *Kahn v. Portnoy*[10] teaches that self-dealing arises where the interests of two companies are in conflict for purposes of a transaction. This is particularly true where, as here, the transaction provides financial benefits to the fiduciary that are detrimental to the company. Thus, in *Portnoy*, the Court of Chancery found that one director was interested in the challenged transaction, in part, because he owned

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[7] *See Aronson*, 473 A.2d at 812.

[8] *Id*. (emphasis added).

[9] *See id.*; *accord Williams v. Geier*, 671 A.3d 1368, 1377 n.19 (Del. 1996); *cf. Cede & Co. v Technicolor, Inc.*, 634 A.2d 345, 363 (Del. 1993) (confirming that *Aronson's* first prong would be satisfied by proof that a "director *either* was on both sides of transaction" or that the director secured a "personal financial benefit" in a manner that "rise[s] to the level of self-dealing").

[10] 2008 WL 5197164 (Del. Ch. Dec. 11, 2008).

RMR, "which receives fees . . . that are allegedly increased by above market rent payments" caused by the challenged transaction.[11] The court also found another RMR-related director interested because the lease transaction created a conflict of interest for the director, who owed fiduciary duties to both the lessee and RMR, which would earn increased fees based on the lease transaction.[12] At no point did the court explore whether the fees were material to RMR or the RMR-affiliated directors during its demand futility analysis. Rather, *Portnoy* correctly recognizes that, where a fiduciary causes a company to engage in a transaction that increases fees paid to another entity with which the fiduciary is affiliated, the fiduciary cannot disinterestedly consider a demand in connection with the transaction.[13]

Defendants do not distinguish *Portnoy* other than to suggest that the court there could reach no other conclusion because both the landlord and tenant were "affiliated with the same entity, RMR." AAB at 23. Defendants' cursory summation of the court's holding ignores the court's rationale – i.e., the directors' conflict of interest due to the increased fees from the transaction benefitting one of their affiliated companies to the detriment of the other. Defendants further ignore the

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[11] *Id*. at *11.

[12] *Id*. at *12 ("Because the interests of these two companies were in conflict for purposes of the Petro Lease Transaction, O'Brien stood on both sides of the transaction and was therefore interested in the transaction.").

[13] *Id*.

fundamental reason why Plaintiff cites the case in the first instance – it shows that a fiduciary can stand on both sides of a facially "third-party" transaction.

The allegations of the First Amended Complaint establish that the Fortress-affiliated directors engaged in self-dealing and stood on both sides of the HLSS acquisition. AOB at 23-29; A858-61, 1373-77, 1393-94. By causing New Residential to structure and finance the HLSS acquisition in a manner that was financially beneficial to Fortress, but detrimental to New Residential, the defendants engaged in the very type of self-dealing that excuses demand without requiring the application of a "materiality" standard. Indeed, after the first attempted acquisition failed due to HLSS's troubles, the Fortress-affiliated directors forced through the acquisition on less favorable terms to New Residential, with at least $200 million in additional costs borne by New Residential.[14] AOB 15-16. The Board restructured the acquisition so that Fortress would substantially increase its management fees, incentive compensation and options, through a stock issuance and public offerings. AOB at 16-19, 25. They also caused New Residential to recharacterize HLSS's income and enter into the Third Management Agreement with FIG, which was also

[14] Although the defendants contend that New Residential acquired HLSS at a discount to HLSS's historical stock price, AAB at 10, the First Amended Complaint alleges that numerous adverse developments at HLSS rendered its historical trading price useless as an indicator of value and caused the market price to decline to far less than what New Residential paid for HLSS. A825.

intended to increase Fortress's incentive compensation. AOB at 17-18, 25-26; A844, 849, 858.

These financial benefits – occasioned by an acquisition that the Fortress-affiliated defendants conceived, structured, revived, and effected without a disinterested committee of directors or stockholder vote – created a conflict of interest between Fortress and New Residential. That conflict of interest placed the directors on both sides of the transaction, because the more New Residential paid to acquire HLSS, the more Fortress would benefit through the issuance of stock and public offerings necessary to finance the acquisition.[15] AOB at 14, 16. Once the transaction closed, the increase to New Residential's asset base would continue to provide Fortress with future financial benefits, regardless of the performance of those assets. In both respects, the Fortress-affiliated directors were conflicted with respect to the HLSS acquisition, which excuses demand here.

2. The Financial Benefits Fortress Secured Through the HLSS Transaction Are Not "Side Benefits"

The financial benefits Fortress received in the transaction are not side benefits, as the defendants contend. In *RCS Creditor Trust v. Schorsch*,[16] – the case upon which the defendants principally rely – the plaintiff challenged three separate transactions, based on its conjecture about certain non-pecuniary benefits that the

[15] *Portnoy*, 2008 WL 5197164, at *12.

[16] 2017 WL 5904716, at *7 (Del. Ch. Nov. 30, 2017).

defendant fiduciaries might have received from the transactions. The alleged benefits were "speculative" at best, as the plaintiff failed to explain (or even attempt to quantify) how the transactions provided any financial benefit to the defendant fiduciaries.[17] Instead, the plaintiff alleged that the defendant fiduciary benefited from these transactions by: (i) "defang[ing] a critic," (ii) purchasing software that would "enable broker dealers to more effectively sell AR Capital's investment products," and (iii) "reduc[ing] competition."[18] The court found that these benefits are the types of side benefits that must be material before excusing demand.[19] Importantly, the plaintiff did not challenge the *RCS* Court's application of a materiality standard as to these three transactions.[20]

In contrast, the substantial financial benefits Fortress received are vital to Fortress's business model and arose out of a restructured transaction that was designed to benefit Fortress at New Residential's expense. AOB at 15-20. Fortress makes its money from the fees it collects from its permanent capital vehicles, like New Residential. A55, FAC ¶48. Fortress did not stand to gain some ancillary benefit that is frequently present when a board acts on a transaction, like continued

[17] *Id.* at *15.

[18] *Id.*

[19] *Id.*

[20] *See* 2017 WL 5904716, at *14.

director fees or employment agreements for members of management.[21] Rather, Fortress stood to gain financial benefits that drive the success of its business.[22] AOB at 19-20. Calling these financial incentives a mere side benefit to Fortress ignores its business model and Plaintiff's well-pled allegations.[23]

Moreover, applying a materiality standard here would grant Fortress free license to engage in future self-dealing transactions without fear of judicial scrutiny, provided that Fortress's financial benefits fall below the materiality threshold. If such a materiality threshold applies, the larger Fortress grows, the more damage it can inflict upon its permanent capital vehicles. Regardless of Fortress's size, the

[21] *See, e.g. Gantler v. Stephens*, 2008 WL 401124, at *10 & n.66 (Del. Ch. Feb. 14, 2008) (identifying common side benefits that rarely materially impact the outcome of a transaction).

[22] Defendants reference *Southeastern Transportation Authority v. Volgenau*, 2013 WL 4009193, at *12 (Del. Ch. Aug. 5, 2013) for their claim that a third-party transaction will not constitute self-dealing just because a controller, like Fortress, receives non-pro rata consideration. AAB at 22. The *Volgenau* Court found on a motion for summary judgment, *not a motion to dismiss*, that the controller's interests were aligned with the minority's interests in a merger transaction that was subject to a special committee process and a stockholder vote. 2013 WL 4009193, at *12, 23. None of those facts are present here.

[23] Defendants' suggestion that Plaintiff waived its ability to argue a distinction between self-dealing and side benefits fails. AAB at 21. Plaintiff alleges and argued below that Fortress engaged in a self-dealing transaction rather than simply receiving side benefits. A40, FAC ¶9; A61-62, FAC ¶56; A93-102, FAC ¶¶121, 123-38; A1373-1374; A1393-1394. In addition, this Court's review is *de novo*, and this Court must judge the sufficiency of Plaintiff's allegations anew. *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

detriment New Residential suffers because of Fortress's self-dealing remains the same.

At a minimum, the financial benefits that Fortress received to the exclusion of, and detriment to, New Residential are sufficient to support a reasonable inference that Fortress engaged in improper self-dealing.[24] Likewise, given Fortress's business model and the ways in which the HLSS acquisition served its financial interests, the Fortress-dominated Board suffers from enough conflicting interests to excuse demand.[25] The ruling below precludes any exploration into this self-dealing acquisition and this Court should not countenance such a result.[26]

B. Plaintiff's Particularized Allegations Support the Reasonable Inference that Fortress Secured Material Benefits

Even if a showing of materiality is required, the court below erred by finding that Plaintiff did not allege facts sufficient to satisfy the materiality standard.[27] AOB

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[24] *See Sinclair Oil*, 280 A.2d at 720.

[25] *Portnoy*, 2008 WL 5197164, at *12.

[26] *See Porter v. Tex. Commerce Bancshares, Inc.*, 1989 WL 120358, at *5 (Del. Ch. Oct. 12, 1989) ("Plainly, for example, a merger that served a private interest of directors, but no corporate or shareholder interest, would constitute or reflect a violation of duty.")

[27] Defendants contend that Plaintiff waived its materiality argument but fail to cite any precedent that supports their contention. AAB at 25. The parties in *In re Infinity Broadcasting Corp. Shareholders Litigation*, 802 A.2d 285, 289 (Del. 2002), expressly indicated to the Court of Chancery that they would not present a standing issue, and the Supreme Court determined that the issue had not been fairly presented for decision. Unlike *Infinity Broadcasting*, the parties here argued the issue of materiality in connection with the defendants' motion to dismiss the First Amended

at 31-38. Defendants advocate in favor of the decision below by asking this Court to draw many unreasonable inferences in their favor and injecting issues of fact that cannot be resolved at this stage of the proceedings. The court below and the defendants also emphasize the absence of certain financial metrics regarding Fortress's size, financial performance and AUM that could potentially be used to measure the significant financial benefits alleged. AAB at 33, 38 & n.4. Plaintiff, however, need not plead a complete financial picture of Fortress to satisfy Rule 23.1 and must remain mindful of the equally applicable mandate of Court of Chancery Rule 8(e)(1) that pleadings be "simple, concise and direct." The First Amended Complaint satisfies Rule 8(e)(1) and 23.1 by including the "particularized factual statements that are essential" to demonstrate that Fortress secured for itself material benefits in connection with the HLSS acquisition.[28]

Complaint and Plaintiff's motion for reargument. *Poe v. Poe*, 872 A.2d 960, 2005 WL 1076524, at *2 & n.7 (Del. May 6, 2005) (argument raised in response to motion for reargument preserved for appeal); *see also Watkins v. Beatrice Cos., Inc.*, 560 A.2d 1016, 1020 (Del. 1989) (merely raising an issue is sufficient to preserve it for appeal). Moreover, the Court's review is *de novo*. *Supra* n. 23. If the defendants' argument hinges on whether Plaintiff used the word "material," that is not a "magic" word. *Orman*, 794 A.2d at 23 n.44. "[S]o long as facts are pled from which a reasonable inference can be drawn that the benefit received from a challenged transaction by that director to the exclusion of the shareholders generally is material to him, a finding of interest may follow." *Id*.

[28] *Brehm*, 746 A.2d at 254.

1. Fortress is the Ultimate Beneficiary of the Benefits its Affiliates Extract from New Residential

Fortress is the ultimate beneficiary of the fees, compensation and options that New Residential gives FIG and FOE I. AOB at 32-33. Plaintiff's allegations confirm: (i) Fortress owns FIG Corp. and FIG Corp. is FOE I's general partner, AOB at 9, 33; (ii) Fortress's permanent capital vehicles, which include New Residential, drive management fees and incentive income to Fortress, *id*. at 34; and (iii) Fortress reports fees and other compensation from FIG and FOE I as revenue, *id*. at 9, 33.[29] Defendants do not rebut (or even address) these allegations and point solely to the lower court's conclusion that the First Amended Complaint did not allege "the percentage of Fortress's ownership of FOE I, through FIG Corp., or the ratio of the alleged benefits to any Fortress financial metric." AAB at 33. Neither of these figures is required to satisfy the applicable pleading standard, as a reasonable inference may be drawn from the First Amended Complaint that Fortress is the ultimate beneficiary.

2. Fortress Secured Material Benefits in the HLSS Acquisition

Plaintiff alleges that Fortress extracted material benefits in connection with the HLSS acquisition. AOB 15-20, 34-38. Chief among them is $1.3 billion in fee-generating AUM with the $500 million in additional fees that Fortress expects to

[29] Fortress's 2014 Form 10-K, which the defendants submitted with the motion to dismiss briefing, also confirms that all of the benefits from the HLSS acquisition directly benefit Fortress and its principals. A334.

earn from that increase in AUM. *Id*. at 34-37. Defendants dismiss this hefty reward as a "beneficial coincidence," AAB at 38, and likewise ignore Plaintiff's particularized allegations that Fortress secured this substantial benefit, which was not shared generally with New Residential's other stockholders, when the Fortress-controlled Board restructured the HLSS acquisition.[30] AOB at 25.

It would be naïve to say that a benefit this substantial is either a coincidence or immaterial.[31] In addition to the sheer magnitude of the benefit, Plaintiff alleges how (i) Fortress was making a transformative shift to permanent capital with a new private equity model, (ii) Fortress was actively seeking to raise and invest capital from its four permanent capital vehicles, including New Residential, and (iii) the New Residential equity raise constituted 55% of all of the capital that Fortress raised through all of its permanent capital vehicles in the first half of 2015. AOB at 34-35; A40, 54-55, 59-62, 99, FAC ¶¶9, 44-47, 54-57, 133.

Just as the Court of Chancery could not easily dismiss as immaterial a $3.3 million fee to a director's company that was contingent on a merger,[32] or the receipt

[30] *See Chen v. Howard*, 87 A.3d 648, 671 (Del. Ch. 2014) (reasonable to infer on a motion for summary judgment that severance, which the board increased *on the same day as the merger*, and other monetary benefits not shared with the stockholders generally were material to director).

[31] *N.J. Carpenters Pension Fund v. Infogroup, Inc.*, 2011 WL 4825888, at *10 & n.44 (Del. Ch. Sept. 30, 2011).

[32] *Id.*

of $100 million in cash contingent on a merger when a person in need of liquidity would receive it,[33] the Vice Chancellor here should not have dismissed as immaterial $1.3 billion of fee-generating AUM that was contingent upon the HLSS acquisition. Viewed another way, much like it is reasonable to infer that the remuneration a person receives from her full-time job is of great consequence to her,[34] it is also reasonable to infer that the AUM generated by Fortress through its permanent capital vehicles, upon which its permanent capital equity structure relies, is of great consequence to it. Thus, Plaintiff's allegations regarding the size and utility of the benefit require that the Court draw a reasonable inference of materiality.[35]

Defendants ineffectively attempt to minimize the impact of Fortress's own investor presentation regarding permanent capital economics, where it used an "Illustrative Example" to advertise the fee stream that Fortress's permanent capital vehicles can generate from a $1 billion increase in capital. AAB at 38-39. By definition, "illustrate" means "to make clear by giving or by serving as an example

[33] *Orman v. Cullman*, 794 A.2d 5, 30-31 (Del. Ch. 2002).

[34] *In re The Student Loan Corp. Derivative Litig.*, 2002 WL 75479, at *3 n.3 (Del. Ch. Jan. 8, 2002).

[35] *Infogroup*, 2011 WL 4825888, at *10 ("In addition to the size of the benefit received by Gupta, the alleged ultimate use of the cash also supports a reasonable inference that this benefit was material to him.").

or instance,"[36] and this "Illustrative Example" makes clear the fee stream that Fortress expects to earn from a $1 billion capital raise. Defendants make the incredible assertion that Plaintiff is engaging in "unsupported speculation" about a "hypothetical additional $500 million" by relying upon this "Illustrative Example." AAB at 39. Plaintiff, however, simply applied Fortress's own business expectations to a real $1.3 billion capital raise to derive the more than $500 million that Fortress expects to earn from the HLSS acquisition. A844; A4803-04. This benefit represents a sizeable and material increase in Fortress's overall revenue, whether it is received immediately or over a period of time. AOB at 36-37.

The defendants also ask this Court to take them at their word that Fortress's investor presentation is "totally unrelated to New Residential." AAB at 39. Delaware law demands a contrary inference, not only because of the applicable pleading standard, but also because the investor presentation specifically concerns New Residential. A61-62, FAC ¶56 (identifying New Residential as one of Fortress's four major enterprises when describing permanent capital vehicles in the investor presentation). In fact, Fortress modeled the "Illustrative Example" after the

[36] *Illustrate*, MERRIAM-WEBSTER ONLINE, https://www.merriam-webster.com/dictionary/illustrate (last visited Feb. 5, 2018).

same compensation structure adopted by New Residential and FIG.[37] *Compare* A62, 74-75, FAC ¶¶57, 85-86 *with* A3208.

Plaintiff further pleads and argued below that Fortress is interested in the HLSS acquisition because it received the immediate benefit of increased fees, incentive compensation, options and stock sales collectively valued in excess of $100 million. AOB at 17-20 (identifying the component parts of the $100 million benefit); A858 (same); A1377 (identifying the $100 million value of the benefits alleged); A1395 (same). It is more than reasonable to infer that benefits this valuable would be material where they represent a 135% increase in the income that Fortress earned from New Residential in 2014. A97-98, FAC ¶130. This is especially true, where, as here, New Residential is alleged to be Fortress's leading generator of management and incentive fees. *Id.* Even if, as the defendants contend, another "denominator" is necessary to calculate the materiality of $100 million to Fortress, AAB at 30, the defendants admit that, in 2014, Fortress earned approximately $1.8

[37] Defendants also claim that the figures in the "Illustrative Example" are "*not* the results Fortress forecast from any particular capital raise." AAB at 39. Defendants' claims regarding the underlying assumptions and applicability of Fortress's "Illustrative Example" are improper attempts to disprove the allegations in the First Amended Complaint, and Plaintiff is entitled to fact discovery to test the accuracy of these claims. *Good v. Getty Oil Co*., 518 A.2d 973, 974 (Del. Ch. 1986).

billion in revenue. A264, 287.[38] Benefits valued at $100 million constitute 5.5% of Fortress's total revenue for 2014, which also demonstrates materiality.

Defendants parse through some of the components that make up the $100 million of immediate benefits, contending that certain components *in isolation* are immaterial to Fortress. The defendants, however, remain silent about the largest piece: the $57 million that Fortress earned in the public offerings used to finance the HLSS acquisition. AOB at 19-20.

With respect to the $6.5 million increase in FIG's management fees, the defendants say that "[o]bviously an increase in New Residential's AUM increases the amount of work to manage those assets," and by extension FIG is simply getting paid more money to do more work. AAB at 33. These, again, are improper *defendant*-friendly inferences, AOB at 28-29, A858-61, 4802, and contrary to Plaintiff's allegations that Fortress receives above-market incentive compensation and free options.[39] A39-40, 75, FAC ¶¶8, 86. Moreover, even if this did constitute

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[38] *In re Ebix, Inc. Stockholder Litig.*, 2016 WL 208402, at *5 n.40 (Del. Ch. Jan. 15, 2016) ("On a motion to dismiss, the Court may consider 'uncontested factual admissions of the parties contained in the record.'"), quoting *Berger v. Intelident Solutions, Inc.*, 911 A.2d 1164, 1166 n.1 (Del. Ch. 2006).

[39] Defendants make a similar unavailing argument that Plaintiff has not alleged that the value of the "5.75 million options" was disproportionate to the value of work performed by FIG in connection with the offerings. AAB at 35. Defendants' arguments with respect to the materiality of the options is also flawed because: (i) Plaintiff alleges that Fortress received a total of 8,543,538 options as a result of the HLSS acquisition and the related public offerings, A99, FAC ¶134; and (ii) the defendants' argument is premised upon information found nowhere in the First

an equivalent value exchange, the defendants do not cite any precedent that supports their view that the receipt of fees and other compensation can only be material if it does not arise out of an equivalent value exchange.[40] Rather, Delaware courts have consistently determined that realism requires the reasonable inference that a substantial increase in compensation, even if it arises out of an equivalent value exchange, can be material to a fiduciary.[41]

Defendants also challenge Plaintiff's allegations that New Residential recharacterized a portion of the income from servicer advances acquired from HLSS, thereby increasing FIG's pro forma incentive compensation by $43.8 million. AOB at 18; A844, 849; A4787, 4803; A5124. Defendants contend that the recharacterization of income was merely an on-paper accounting adjustment with no

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Amended Complaint regarding New Residential Investment Corp.'s Nonqualified Stock Option and Incentive Award Plan, dated April 29, 2013, and its purported administration by New Residential's Compensation Committee. A1375.

[40] *In re Sanchez Energy Derivative Litig.*, 2014 WL 6673895 (Del. Ch. Nov. 25, 2014) is inapposite as it concerned a substantive challenge to a transaction under the second prong of *Aronson* and the Court of Chancery applied a standard similar to waste.

[41] *See, e.g., In re The Student Loan Corp.*, 2002 WL 75479, at *3 & n.3 (explaining that compensation "is typically of great consequence" to a person even when that compensation is paid in exchange for employment); *In re Primedia Inc. Derivative Litig.*, 910 A.2d 248, 261 n.45 (Del. 2006) (same); *Orman*, 794 A.2d at 30 (finding extension of existing contract for consulting services with surviving entity a material benefit to director).

financial impact.[42] AAB at 34-35. The ultimate impact of the recharacterization is an issue of fact that should not be resolved on a motion to dismiss.[43] AOB at 18. As a result, the defendants fail to overcome Plaintiff's particularized allegations that are sufficient to satisfy the materiality standard.

3. Fortress Is Incentivized to Extract the Unshared and Material Benefits Alleged Because Its Interests Are Not Aligned with New Residential's Other Stockholders

Fortress and its principals control every aspect of New Residential and its Board,[44] but maintain a limited 7.4% equity stake. AOB at 7-10. Fortress structures its control in this way in order to maximize its ability to extract fees, options and other financial benefits without the concomitant risks of majority equity ownership. A59, FAC ¶53. The practical consequence of this structure is that Fortress's interests are not aligned with New Residential and its other stockholders.[45] As the cost of the

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[42] Plaintiff never conceded this point, AAB at 34, and explained at oral argument that, "even if" the defendants were correct, the recharacterization still demonstrates self-dealing and materiality. A5124-25.

[43] *See supra* n.37.

[44] Defendants concede that the court below did not decide whether Fortress controlled New Residential. AAB at n.3. Issues not resolved by the Court of Chancery are not properly before this Court for decision. *D'Angelo v. Petroleos Mexicanos*, 331 A.2d 388, 392 (Del. 1974). To the extent this Court finds the issue relevant, Plaintiff is entitled to the reasonable inference arising out of its particularized allegations that Fortress dominated every aspect of New Residential, including its Board, and as set forth herein exercised that control in connection with the HLSS acquisition. AOB at 7-10.

[45] *In re EZCorp Inc. Consulting Agreement Derivative Litig.*, 2016 WL 301245, at *2 (Del. Ch. Jan. 25, 2016). The misalignment of interests between Fortress and

HLSS acquisition rose, so too did the New Residential equity issued to fund it and the AUM and fees that Fortress would earn from the increase in equity. A847-50.

Defendants concede that, if Fortress controls New Residential, *and it does*, Fortress can force through equity offerings and, by logical extension, favorable amendments to FIG's management agreement. AAB at 37. Fortress has already demonstrated its propensity to engage in this type of self-dealing. Fortress exercised its control in the HLSS acquisition to force through equity offerings and manipulate the calculation of its incentive compensation to ensure that its compensation will increase regardless of how the HLSS assets perform. A849, 5124-27, 5132.

Defendants take an unduly narrow view of Fortress's interests in New Residential. They highlight FIG's incentive compensation structure and the receipt of options and claim that Fortress would not jeopardize New Residential's returns by causing it to overpay for HLSS. AAB at 37. Fortress's interest in the benefits alleged far exceeds any potential negative impact on its relatively small equity position that consists primarily of New Residential options. A858-61. Defendants do not properly account for the lucrative increase in management fees that Fortress assured itself, the valuable income that Fortress earned through cashless option exercises and stock sales in the public offerings, the exclusive protection from equity

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New Residential renders the defendants' cited authorities inapplicable. AAB at 26-27.

dilution, and Fortress's manipulation of the incentive compensation structure. In other words, while New Residential's other stockholders shoulder the excessive cost and risk of the HLSS acquisition, Fortress disproportionately benefits and rests assured that its fees and other compensation will materially increase.

C. A Majority of the New Residential Board – Including Douglas Jacobs – Is Neither Disinterested Nor Independent

The court below correctly found that at least half of the New Residential Board was not independent of Fortress because of dual fiduciary positions.[46] Indeed, Plaintiff alleges that a majority of the New Residential Board receives director fees from multiple boards of Fortress-affiliated companies. Combined with Fortress's self-dealing and material interests in the HLSS acquisition, these dual-fiduciary roles are reason enough to doubt the Board's ability to disinterestedly and independently consider a demand. A829-32, 851-57.

Defendants argue that the court erred with regard to director Douglas Jacobs because he was "not exercising power as a Fortress fiduciary" and was "free to consider only New Residential's interests." AAB at 41. To the contrary, as a Fortress and New Residential director, Jacobs' fiduciary duty to push through the HLSS acquisition in order to maximize financial benefits for Fortress conflicted with

[46] AOB at Ex. A, First Op. at 27. Because the court below found that Plaintiff cast a reasonable doubt on "at least" half of the New Residential directors' disinterestedness and independence (including Edens, Nierenberg and Jacobs), the court did not analyze the remaining directors. *Id*. at 26-27 & n.64.

his duty to minimize the costs to New Residential.[47] Because of Fortress's self-dealing and material interests in the HLSS acquisition, Jacobs was "exercising power" on behalf of Fortress when he restructured the HLSS acquisition in favor of Fortress.[48]

Defendants rely on *Heineman v. Datapoint Corp.*,[49] and *Hartsel v. Vanguard Group, Inc.*[50] for the general proposition that service on multiple boards alone is insufficient to cast doubt on a board's independence. AAB at 41-42. Plaintiff's allegations, with respect to Jacobs, however, do not end at his interlocking directorships. Plaintiff alleges that Jacobs: (i) held multiple board seats in a web of Fortress-affiliated entities, A48-50, FAC ¶25-28; A854; (ii) earned millions of dollars while serving as a director of multiple Fortress-affiliated entities for over a decade, A49-50, FAC ¶30; A830-31, 854-56; (iii) received over $450,000 for his service as a director of Fortress-affiliated entities in 2014 alone, *id.*; and, (iv) was a

[47] *Portnoy*, 2008 WL 5197164, at *11-13 (finding a director interested in a transaction where the director owed fiduciary duties to "two companies [that] were in conflict for purposes of the…[t]ransaction").

[48] Jacobs stands in stark contrast to the controlling stockholder in *Odyssey Partners, L.P. v. Fleming Cos.*, 735 A.2d 386, 415 (Del. Ch. 1999), which was balancing roles as a controlling stockholder and a creditor in a challenged transaction but was found to not be "acting in a fiduciary capacity" when exercising statutory rights that derived from its status as a creditor.

[49] 611 A.2d 950, 955 (Del. 1992).

[50] 2011 WL 2421003, at *22 (Del. Ch. June 15, 2011).

67-year-old retiree without tremendous wealth, A49-50, FAC ¶¶29, 31; A856. These allegations, together with Fortress's self-dealing and material financial interest in the HLSS acquisition, are sufficient to raise a reasonable doubt that Jacobs is capable of exercising independent business judgment with respect to the HLSS acquisition.[51]

Plaintiff sufficiently pleads demand futility under the first prong of *Aronson*. As a result, the trial court erred by dismissing Counts I and II of the First Amended Complaint. The viability of Counts I and II ensures that Count III for declaratory relief with respect to the Termination Agreement stands as a valid and ripe claim. This Court should remand this matter for further proceedings.

[51] *Portnoy*, 2008 WL 5197164, at *12. Defendants conceded below that there is reason to doubt the independence of Edens and Nierenberg from Fortress. A1329. Even if this court accepted the defendants' implausible argument that Jacobs is independent of Fortress, Plaintiff's particularized allegations are sufficient to show that one or more of the remaining three directors are also beholden to Fortress. A830-32, 854-57. Thus, the defendants fail to state any alternative ground to affirm the dismissal below.

CONCLUSION

For the reasons set forth herein and in Appellant's Corrected Opening Brief, the Court of Chancery's dismissal of the First Amended Complaint should be reversed and this matter should be remanded for further proceedings.

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