UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT
Thurgood Marshall U.S. Courthouse 40 Foley Square, New York, NY 10007 Telephone: 212-857-8500

MOTION INFORMATION STATEMENT

Docket Number(s): 13-4488-cv(L)

Caption [use short title]

Motion for: leave to file amicus brief

AHW Investment Partnership v. Citigroup, Inc.

Set forth below precise, complete statement of relief sought:

Leave to File an Amicus Brief on Behalf of Defendants-Appellees-Cross-Appellants' cross appeal seeking reversal of the district court's order ruling Plaintiffs' claims are not derivative under Delaware law

MOVING PARTY: Sec. Industry and Fin. Markets Assoc.

☐ Plaintiff ☐ Defendant
☐ Appellant/Petitioner ☐ Appellee/Respondent

OPPOSING PARTY: See Addendum

MOVING ATTORNEY: Jay B. Kasner

OPPOSING ATTORNEY: See Addendum

[name of attorney, with firm, address, phone number and e-mail]

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Court-Judge/Agency appealed from: United States District Court, Southern District of New York, H. Sidney H. Stein

Please check appropriate boxes:

Has movant notified opposing counsel (required by Local Rule 27.1):
☑ Yes ☐ No (explain): ______

Opposing counsel's position on motion:
☑ Unopposed ☐ Opposed ☐ Don't Know

Does opposing counsel intend to file a response:
☐ Yes ☐ No ☑ Don't Know

FOR EMERGENCY MOTIONS, MOTIONS FOR STAYS AND INJUNCTIONS PENDING APPEAL:

Has request for relief been made below? ☐ Yes ☐ No
Has this relief been previously sought in this Court? ☐ Yes ☐ No
Requested return date and explanation of emergency: ______

Is oral argument on motion requested? ☐ Yes ☑ No (requests for oral argument will not necessarily be granted)

Has argument date of appeal been set? ☐ Yes ☑ No If yes, enter date: ______

Signature of Moving Attorney: ______ **Date:** 6/11/2014

Has service been effected? ☑ Yes ☐ No [Attach proof of service]

ORDER

IT IS HEREBY ORDERED THAT the motion is **GRANTED DENIED**.

FOR THE COURT:
CATHERINE O'HAGAN WOLFE, Clerk of Court

Date: ______ By: ______

Form T-1080

Addendum to Form T-1080 Motion Information Sheet

Opposing Parties and Counsel Therefor

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13-4488-cv(L),
13-4504-cv(XAP)

United States Court of Appeals

for the

Second Circuit

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

(For Continuation of Caption See Inside Cover)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

MOTION FOR LEAVE TO FILE AN *AMICUS CURIAE* BRIEF ON BEHALF OF SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLEES-CROSS-APPELLANTS

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Attorneys for Amicus Curiae Securities Industry and Financial Markets Association

the Angela Williams Grantor Retained Annuity Trust UAD July 1, 2008, and the Angela Williams Grantor Retained Annuity Trust UAD November 21, 2008,

Plaintiffs-Appellants-Cross-Appellees,

– v. –

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

Defendants-Appellees-Cross-Appellants.

Pursuant to Federal Rule of Appellate Procedure 29, amici, the Securities Industry and Financial Markets Association ("SIFMA"), respectfully moves for leave to file the attached brief as *amicus curiae* in support of defendants-appellees-cross-appellants' cross appeal seeking reversal of the district court's order ruling that plaintiffs' claims are not derivative under Delaware law.[1]

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").[2]

SIFMA has an interest in the current proceeding because Plaintiffs-Appellants-Cross-Appellees ("Plaintiffs") urge the Court to interpret Delaware law as it applies to so-called "holder" claims in a manner that would eliminate important safeguards against frivolous or wasteful corporate litigation and disrupt

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[1] Pursuant to Local Rule 29.1, SIFMA represents that no party to this action or their counsel authored this brief in whole or in part, no party to this action or their counsel contributed money that was intended to fund preparing or submitting this brief, and no person other than SIFMA, its members, and its counsel contributed money that was intended to fund preparing or submitting this brief.

[2] For more information, visit www.sifma.org.

the central role that the board of directors plays in matters of corporate governance. SIFMA represents issuers, underwriters and investors whose rights would be affected by the Court's determination of the issue on cross-appeal: namely, whether the harm alleged by Plaintiffs in this case may be pursued directly by individual shareholders or whether it must be brought derivatively on behalf of the corporation and therefore be subject to the protections that Delaware law provides in derivative suits.

Delaware's rules regarding when shareholders may sue individually as opposed to derivatively are intended to protect both corporations and shareholders from frivolous litigation that is being advanced solely for the benefit of a single shareholder. Allowing holders or, as here, former holders, of stock to assert directly on their own behalf claims that are based on injuries suffered by the corporation would undermine the protections that Delaware has developed for derivative lawsuits and would disrupt the ability of directors of public corporations to manage the corporation's litigation rights. Ceding control over corporate litigation to individual shareholders could also give rise to the assertion of frivolous lawsuits against third party underwriters or advisors in a manner that could disrupt relationships between those third parties and their corporate clients.

The Court's decision on this issue will have a significant effect on SIFMA's members because most publicly traded corporations are incorporated under Delaware law and many other jurisdictions follow Delaware corporation law. Therefore, a ruling on the application of Delaware law in these circumstances will affect the ability of the boards of directors of SIFMA's members and clients to control their corporation's litigation rights, and will subject investors generally with the burden and expense of easily manufactured "holder" claims.

Dated: New York, New York
June 11, 2014

Respectfully submitted,

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AMICUS BRIEF

13-4488-cv(L),

13-4504-cv(XAP)

United States Court of Appeals

for the

Second Circuit

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(For Continuation of Caption See Inside Cover)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLEES-CROSS-APPELLANTS

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Defendants-Appellees-Cross-Appellants.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Amicus Curiae the Securities Industry and Financial Markets Association states that it has no parent corporation and that no publicly held corporation owns 10% or more of its stock.

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The Securities Industry and Financial Markets Association ("SIFMA") respectfully submits this brief as amicus curiae in support of defendants-appellees-cross-appellants' cross appeal seeking reversal of the district court's order ruling that plaintiffs' claims are not derivative under Delaware law.[1]

STATEMENT OF INTEREST OF THE AMICUS CURIAE

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").[2]

SIFMA has an interest in the current proceeding because Plaintiffs-Appellants-Cross-Appellees ("Plaintiffs") urge the Court to interpret Delaware law as it applies to so-called "holder" claims in a manner that would eliminate important safeguards against frivolous or wasteful corporate litigation and disrupt

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1 Pursuant to Local Rule 29.1, SIFMA represents that no party to this action or their counsel authored this brief in whole or in part, no party to this action or their counsel contributed money that was intended to fund preparing or submitting this brief, and no person other than SIFMA, its members, and its counsel contributed money that was intended to fund preparing or submitting this brief.

2 For more information, visit www.sifma.org.

the central role that the board of directors plays in matters of corporate governance. SIFMA represents issuers, underwriters and investors whose rights would be affected by the Court's determination of the issue on cross-appeal: namely, whether the harm alleged by Plaintiffs in this case may be pursued directly by individual shareholders or whether such harm must be addressed derivatively on behalf of the corporation and therefore be subject to the protections that Delaware law provides in derivative suits.

Delaware's rules regarding when shareholders may sue individually as opposed to derivatively are intended to protect both corporations and shareholders from frivolous litigation that is being advanced solely for the benefit of a single shareholder. Allowing holders or, as here, former holders, of stock to assert directly on their own behalf claims that are based on injuries suffered by the corporation would undermine the protections that Delaware has developed for derivative lawsuits and would disrupt the ability of directors of public corporations to manage the corporation's litigation rights. Ceding control over corporate litigation to individual shareholders could also give rise to the assertion of frivolous lawsuits against third party underwriters or advisors in a manner that could disrupt relationships between those third parties and their clients or counterparties.

The Court's decision on this issue will have a significant effect on SIFMA's members because most publicly traded corporations are incorporated under Delaware law and many other jurisdictions follow Delaware corporation law. Therefore, the ruling on Delaware law sought by SIFMA will protect the ability of the boards of directors of SIFMA's members, clients and counterparties to control their corporation's litigation rights, and will help investors to avoid the burden and expense of dubious, easily manufactured "holder" claims.

SUMMARY OF ARGUMENT

Plaintiffs in this action are shareholders of Citigroup who seek money damages for losses they incurred because they continued to hold Citigroup stock during the subprime mortgage crisis that wreaked havoc on the financial markets between 2007 and 2009. Based on perfect hindsight, Plaintiffs claim that they would have sold their stock in 2007 had they known the true extent of Citigroup's exposure to subprime assets. Recognizing the "undeterminable and speculative" nature of the relief Plaintiffs seek, the court below (the "District Court") dismissed Plaintiffs' claims because they failed to allege any cognizable damages proximately caused by Citigroup's alleged fraud.

Nevertheless, the District Court rejected Defendants' alternative argument that Plaintiffs were precluded at the outset from pursuing their claims individually because these claims are typically asserted derivatively on behalf of Citigroup and not directly by shareholders themselves. Defendants have filed a cross-appeal challenging that ruling, and argue that, under applicable Delaware law, Plaintiffs' so-called "holder" claims may only be brought derivatively. SIFMA submits this brief to address the policy considerations for adhering to Delaware precedent precluding plaintiffs from pursuing direct claims where they are seeking recovery for harm to the corporation itself.

As a matter of policy, to allow individual shareholders to pursue direct "holder" claims to recover purported individual losses based on a drop in a company's stock price (as Plaintiffs do here) would result in an avalanche of easily manufactured, groundless, difficult to prove and disruptive claims that would flood the dockets of state and federal courts. After all, fraud claims by persons who merely abstained from selling could plausibly be brought following any significant swing in a corporation's market capitalization and would be difficult to resolve without a trial. As discussed below, such claims are truly based on purported corporate injuries arising from allegations of mismanagement. The Court need not invent direct "holder" claims to remedy those types of losses because courts in Delaware and elsewhere long ago recognized that shareholders could address corporate wrongs through specialized standing in the form of the shareholder derivative suit. But because shareholder derivative suits were often vehicles for abusive "strike suits," important procedural and substantive standings were imposed in such suits, including the pre-suit demand requirement (*see Aronson v. Lewis*, 473 A.2d 801, 812 (Del. 1984); Fed.R.Civ.P. 23.1) and the "contemporaneous" and "continuous" share ownership requirements. *See Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984).

The test for determining whether claims are direct or derivative is well established. Delaware law provides that a shareholder may only bring a claim directly against the corporation and its directors and officers if the shareholder demonstrates "that he or she can prevail *without* showing an injury to the corporation[.]" *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004). Applying this rule, Delaware courts have determined that harm to the "actual value" of a corporation's stock generally will only support a derivative claim. More specifically, over a decade ago, the Delaware Supreme Court unanimously affirmed the Delaware Court of Chancery's ruling that a purported "holder" class action actually asserted derivative claims and not claims belonging directly to the shareholders. *See Manzo v. Rite Aid Corp.*, No. Civ. A. 18451-NC, 2002 WL 31926606, at *5 (Del. Ch. Dec. 19, 2002), *aff'd*, 825 A.2d 239 (Del. May 29, 2003). The District Court erred by failing to follow that controlling Delaware Supreme Court precedent.

A thorough application of the *Tooley* test confirms that conclusion. Here, Plaintiffs' claims are derivative because the only damages that are possibly cognizable in this action belong to the corporation. As courts across the country have recognized, Plaintiffs' could not have sold their stock before the rest of the market was aware of the purported fraud is not plausible. Thus, as Plaintiffs are forced to admit, the only recovery they can seek is based on a diminution in the actual value of their stock as a result of Citigroup's corresponding loss of value arising from its investment in subprime assets. The injury in this situation is to Citigroup as an entity and the recovery for that injury should go to Citigroup.

Reversal of the District Court's ruling on this issue is essential to maintain the certainty and predictability to which Delaware corporations and their shareholders are entitled in matters regarding the corporations' internal affairs. Delaware law imposes many important substantive and procedural limitations on derivative plaintiffs to protect corporations and their shareholders from the expense and disruption of litigation, which Plaintiffs cannot satisfy here.

For these reasons and those set forth below, SIFMA respectfully requests that the Court reverse the District Court's ruling that Plaintiffs' claims are direct.

ARGUMENT

I. THE DISTRICT COURT ERRED IN RULING THAT PLAINTIFFS' "HOLDER" CLAIMS ARE DIRECT UNDER DELAWARE LAW.

A. The Shareholder Derivative Suit Is The Appropriate Remedy For The Alleged Harm Suffered By Plaintiffs Here.

Plaintiffs themselves describe their claims as "'holder' claims – claims by a shareholder fraudulently induced to retain his stock rather than one fraudulently induced to purchase or sell it." (PB at 1)[3] Courts have appropriately been skeptical of such "holder" claims as a matter of policy because of the inherently speculative nature of an injury suffered by alleged inaction. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (refusing to recognize holder fraud claim for claims brought under Section 10(b) of the Securities Exchange Act of 1934). As the Supreme Court explained in *Blue Chip*, "bystanders to the securities marketing process could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and unduly pessimistic predictions by the issuer followed by a rising market caused them to allow retrospectively golden opportunities to pass." *Id.* at 747. The potential for windfall recoveries based on easily manufactured

[3] References to Plaintiffs-Appellants-Cross-Appellees' Brief are in the form "PB __." References to Defendants-Appellees-Cross-Appellants' Brief are in the form "DB __."

allegations of forebearance provides strong policy grounds to be dubious of permitting "holders" from pursuing such relief.

In an attempt to reduce the inherently speculative nature of their claims, Plaintiffs argue that they do not seek relief based on any speculative hypothetical bargain but based on the loss in "actual value" of their Citigroup stock when it declined from $51.59 to $3.09 per share as a result of Citigroup's decision to invest in subprime mortgage assets and the subsequent collapse of subprime markets. But the Court need not invent new forms of relief to provide a remedy for shareholders who contend that corporate mismanagement caused the actual value of a corporation to decline. Since the nineteenth century, courts have granted shareholders of corporations standing as a matter of equity to maintain a cause of action on behalf of the corporation to remedy injuries to the corporation committed by management or third parties. *See, e.g., Hawes v. Oakland*, 104 U.S. 450, 454 (1881) (recognizing that a shareholder may sue on behalf of a corporation as a matter of equitable jurisprudence). As explained below, the so-called "holder" claims asserted here fit squarely into the derivative suit framework. Creating another cause of action that allows shareholders or former shareholders to sue directly for an injury that is suffered by the corporation itself would create the risk of conflicting or duplicative relief based on dubious and uncorroborated hindsight assertions of those shareholders or former shareholders. *See Smith v. Waste Mgmt.*, *Inc.*, 407 F.3d 381, 385 (5th Cir. 2005) ("By finding that Smith's claims are derivative, we ensure that Smith will not incur a benefit at the expense of other sharehold̈er similarly situated."); *In re J.P. Morgan Chase & Co.*, 906 A.2d 766, 770, 773 (Del. 2006)(rejecting argument that there could be both individual and derivative recovery because that would mean that the directors "would be liable to pay both the corporation and its shareholders the same compensatory damages for the same injury"); *Cowin v. Bresler*, 741 F.2d 410, 414 (D.C. Cir. 1984) ("Requiring derivative enforcement of claims belonging in the first instance to the corporation also prevents an individual shareholder from incurring a benefit at the expense of other shareholders similar situated.").

B. Delaware Law Precludes Shareholders From Suing Directly If The Success Of Their Claims Depends On Showing An Injury To The Corporation.

In the proceedings below, the District Court and the parties all agreed that Delaware law applies to the question of whether Plaintiffs' claims are direct or derivative. (SPA 5-6) "'The law of the state of incorporation normally determines issues relating to the internal affairs of a corporation' because '[a]pplication of that body of law achieves the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation.'" *NatTel, LLC v. SAC Capital Advisors LLC*, 370 F. App'x 132, 134

(2d Cir. 2006) (quoting *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983)).

The District Court and the parties also agreed that the test for determining whether Plaintiffs' claims are direct or derivative was set forth by the Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). The *Tooley* test "turn[s] *solely* on" two questions: "(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or remedy (the corporation or the stockholders, individually)?" *Id.* at 1033.

In formulating these two questions, the *Tooley* court rejected prior Delaware cases that had applied a "bright-line" rule to distinguish between direct and derivative claims – namely, that "'a suit must be maintained derivatively if the injury falls equally upon all shareholders.'" *Tooley*, 845 A.2d at 1037. The *Tooley* court described this approach as "confusing and inaccurate" because there may be circumstances where an indisputably direct stockholder claim could involve a harm that falls on all stockholders equally. *Id.* at 1037. Accordingly, *Tooley* states that the appropriate inquiry should focus on whether "the plaintiff has demonstrated that he or she can prevail *without* showing an injury to the corporation[.]" *Id.* at 1036 (emphasis added). In other words, although a shareholder may be able to state a direct claim even if the injury was suffered by all shareholders equally, it can only do so if that injury is independent of any injury to the corporation. *Id.* In cases following *Tooley*, the Delaware Supreme Court has emphasized that shareholders must state an independent injury to maintain a direct claim. *See Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008) (affirming dismissal of claims as derivative because the harm was not "separate and distinct from the alleged harm to the Company"); *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 770, 774 (Del. 2006) (affirming dismissal of claims as derivative because "'the damages allegedly flowing from the disclosure violation are exactly the same as those suffered by [the corporation]'" (citation omitted)).

Under the *Tooley* test, an examining court is not bound by the plaintiffs' characterization of either the alleged harm or the relief that will be awarded. Rather, *Tooley* counseled that courts should "independently examine the nature of the wrong alleged and any potential relief...." 845 A.2d at 1035. *See also Newman v. Family Mgmt. Corp.*, 530 F. App'x 21, 27 (2d Cir. 2013) ("[w]e 'must look to all the facts of the complaint and determine for [ourselves] whether a direct claim exists'" (alteration in original)) (quoting *Dieterich v. Harrer*, 857 A.2d 1017, 1027 (Del. Ch. 2004)). Indeed, Delaware courts have routinely rejected plaintiffs' attempts to characterize their claims as direct. *See, e.g.*, *Feldman*, 951 A.2d at 733 (rejecting plaintiff's "creative attempt to recast the derivative claim . . . by alleging the same fundamental harm in a slightly different way"); *Hartsel v.*

Vanguard Grp., Inc., No. 5394-VCP, 2011 WL 2421003, at *16 (Del. Ch. June 15, 2011) ("The manner in which a plaintiff labels its claim and the form of words used in the complaint are not dispositive[.]"), *aff'd*, 38 A.3d 1254 (Del. 2012); *In re Syncor Int'l. Corp. S'holders Litig.*, 857 A.2d 994, 999 (Del. Ch. 2004) ("[A] claim is not direct simply because it is pleaded that way."); *Agostino v. Hicks*, 845 A.2d 1110, 1119 (Del. Ch. 2004) (refusing to "allow a plaintiff's designation to trump the body of the complaint").

Here, although Plaintiffs purport to be suing directly, their claims are derivative because they cannot prevail without first showing an injury to Citigroup.

C. Plaintiffs Cannot Prevail On Their Holder Claims Without First Showing An Injury To Citigroup.

1. Citigroup suffered the alleged harm.

Plaintiffs' appellate brief leaves no doubt that the injury for which they seek redress was an injury to Citigroup. Although they premise their entitlement to an independent recovery on the fact that they planned to sell their stock in May 2007, they insist that "that 'alternative contractual bargain' plays ***no role*** in their damages calculation." (PB 40) In other words, they are not seeking recovery based on any artificial inflation caused by fraud. (PB 42) Instead, they claim that the "only loss for which they seek damages is the true out-of-pocket loss they suffered when the ***actual value*** of their stock fell over time." (*Id.*)

The District Court determined that Plaintiffs had stated an independent injury because it believed they were alleging harm caused by the concealment of "damage to Citigroup's assets that had already been done." (SPA 7) But Plaintiffs have disclaimed any recovery for damage to Citigroup's assets that occurred before the alleged concealment. (DB 28, n.9) According to Plaintiffs, at the time of the alleged fraud, Citigroup's exposure to subprime assets "was only a ***risk***." (PB 44) The alleged harm – the decline in the "actual value" of Citigroup stock – did not occur until March 2009 when the subprime markets collapsed and the risks of exposure to subprime assets materialized. (*Id.* ("The complaint alleges that Citigroup's stock price fell because of the materialization of the subprime risks"))

Indeed, Plaintiffs' claimed injury to the "actual value" of Citigroup stock is premised on allegations that its managers "fail[ed] to properly monitor and manage subprime risk" (A.42 ¶ 96), underwrote loans of poor quality (A.50 ¶¶ 126-27), failed to calculate loss reserves correctly (A.51 ¶ 135), and failed to perform proper risk assessments. (A.56-57 ¶¶ 162-68) Under Delaware law, when a shareholder asserts that the "actual value" of its stock declined because the corporation was mismanaged, any harm to the shareholder is entirely dependent on harm to the corporation itself, and the shareholder may only bring the claim derivatively. *See Kramer v. W. Pacific Indus., Inc.*, 546 A.2d 348, 353 (Del. 1988)

("Delaware courts have long recognized that actions charging 'mismanagement which depress the value of stock [allege] a wrong to the corporation....'" (alterations in original)(citation omitted)); *Metropolitan Life Ins. Co. v. Tremont Grp. Holdings, Inc.*, No. Civ. A. 7092-VCP, 2012 WL 6632681 , at *9 (Del. Ch. Dec. 20, 2012) (allegations that "misconduct made [fund] less valuable" stated injury that was "neither direct nor something that existed independently of the [fund]"); *Hartsel*, 2011 WL 2421003, at *17 ("Under Delaware law, allegations of trustee or director mismanagement regarding securities portfolio investments generally are considered derivative in nature."); *Agostino,* 845 A.2d at 1123 (because the "nature of this claim is nothing more than a claim of mismanagement," "'the wrong alleged is entirely derivative'").

In fact, the Delaware Supreme Court reached this very conclusion in unanimously affirming the Delaware Court of Chancery's dismissal of another case involving holder claims. In *Manzo v. Rite Aid Corp.,* the plaintiff alleged that Rite Aid and its directors had made "material omissions and affirmative misrepresentations, falsely overstating earnings and the value of assets" which "artificially inflat[ed] the price at which Rite Aid stock traded." No. 18451-NC, 2002 WL 31926606, at *1-2 (Del. Ch. Dec. 19, 2002) (unpublished table decision), *aff'd*, 825 A.2d 239 (Del. May 29, 2003). Manzo sought damages based on the "return she *could* have earned had she invested elsewhere," instead of being induced to hold her Rite Aid stock. *Id.* at *5. The Delaware Court of Chancery held that the injury Manzo identified – that she "received a poor rate of return on her Rite Aid shares" because she "was deprived of accurate information on which to base investment decisions" – was a derivative injury. *Id.*

In reaching that conclusion, the Chancellor relied on a decision of the Delaware Supreme Court, *Malone v. Brincat,* which concerned allegations that "'as a direct result of the false disclosures ... the Company has lost all or virtually all of its value (about $2 billion).'" *Id.* at 722 A.2d 5, 8 (Del. 1998). The court held that those allegations "claim an injury to the corporation." *Id.* at 14. Although both *Malone* and *Manzo* were decided before *Tooley*, they are fully consistent with the *Tooley* standard. Indeed, the court in *Manzo* engaged in the same inquiry that *Tooley* later adopted: "In order to determine whether a claim is direct or derivative, the Court looks to the nature of the harm and the relief available upon success of the suit." 2002 WL 31926606, at *5. In fact, in cases decided after *Tooley*, other courts have relied on *Manzo* and have dismissed holder claims because they state a derivative injury. *See, e.g.*, *Smith v. Waste Mgmt., Inc.*, 407 F.3d 381, 384-85 (5th Cir. 2005); *In re Bank of Am. Corp. Sec., Derivative & ERISA Litig.*, No. 12 Civ. 5210(PKC), 2013 WL 6504801, at *17 (S.D.N.Y. Dec. 11, 2013); *Lee v. Marsh & McLennan Cos.*, 17 Misc. 3d 1138(A), 2007 N.Y. Slip Oo. 52325(U) (N.Y. Sup. Ct. Dec. 7, 2007). Furthermore, the Second Circuit, applying *Tooley*, has twice held that "holder" misrepresentation and fraud claims are derivative. *See Newman v. Family Management Corp.*, 530 Fed. App'x. 21, 27 (2d Cir. July 16, 2013); *Stephenson v. PriceWaterhouseCoopers, LLP*, 482 Fed. App'x. 618, 621 (2d Cir. May 18, 2012).

The District Court nevertheless believed there is a tension in Delaware law regarding whether holder claims are direct or derivative. (SPA 7-8) But that conclusion is incorrect for several reasons. First, the District Court misstated *Manzo*'s ruling. Although the court *quoted* language from *Malone* "'that intentional misrepresentations to 'holders' of stock ... could give rise to *either* a direct or a derivative claim,'" the Chancellor *ruled* that the holder claims in that case were derivative. *Manzo*, 2002 WL 31926606, at *5-6. The District Court attempted to distinguish that ruling because the court in *Manzo* was examining a claim for breach of fiduciary duty, instead of fraud. (SPA 9 (noting that "the duty here is owed to members of the investing public"))[4] But the *injury* asserted in *Manzo* is precisely the same as Plaintiffs assert here: the plaintiff alleged that she

[4] It is puzzling why the District Court thought this distinction was material because *Albert v. Alex. Brown Mgmt. Servs., Inc.* – the other Delaware case that the District Court believed was in tension with *Manzo* – also examined a claim for breach of fiduciary duty, not fraud. *See* Civ. A. Nos. 762-N, 763-N, 2005 WL 2130607, at *12 (Del. Ch. Aug. 26, 2005) (noting plaintiffs had alleged violation of "contractual and *fiduciary* duties" (emphasis added)). The District Court did not explain why the distinction mattered with respect to *Manzo* but not *Albert*.

"received a poor rate of return on her Rite Aid shares" because she "was deprived of accurate information on which to base investment decisions." 2002 WL 31926606, at *5. As both *Manzo* and *Tooley* recognized, it is the *injury* that matters, not the theory of liability. The Delaware Supreme Court has emphasized this in more recent cases and has rejected attempts to "bootstrap" harm suffered by a corporation onto "an independently arising direct cause of action." *See Feldman*, 951 A.2d at 733 (citing *J.P. Morgan*, 906 A.2d at 771-74)).

Nor was the District Court correct when it concluded that *Albert v. Alex. Brown Management Services, Inc.* is in tension with the holding in *Manzo.* (SPA 7) That case also involved allegations that investors "lost their opportunity" to divest themselves of their share in the company because of a purported "fail[ure] to disclose material information." *Albert v. Alex. Brown Mgmt. Sers, Inc,.* Civ. A. Nos. 762-N, 76N, 2005 WL 2130607, at *12 (Del. Ch. Aug. 26, 2005). But those investors were limited partners who had a *contractual right* to redeem their share of the partnership. *See Albert v. Alex. Brown Mgmt. Servs., Inc.*, Civ. A. Nos. 762-N, 763-N, 2005 WL 5750601, at *6 (Del. Ch. June 29, 2005) (noting that partnership agreements "provided for limited redemption rights after the second anniversary of an investor's admission to the Fund"). *Albert* does not support the conclusion that holders like Plaintiffs – who have no personal contractual right to redeem their shares – can state a direct claim. *Cf. Allen v. El Paso Pipeline GP Co.*, No. 7520-VCL, 2014 WL 2086246, at *8-9 (Del. Ch. May 19, 2014) (noting "longstanding principle that a stockholder suffers injury when its contractual rights are breached" and "may sue individually").

The District Court also cited *Albert* for the proposition that "[g]enerally, non-disclosure claims are direct claims." (SPA 7); 2005 WL 2130607, at *12. But disclosure claims are "generally" direct claims because they nearly always concern a request for shareholder action, such as voting or a tender offer. The right to cast an informed vote is "traditionally regarded as [an] 'incident[]' of stock ownership," so an injury to that right is appropriately viewed as an individual injury. *Manzo*, 2002 WL 31926606, at *6. *Manzo* distinguished those types of non-disclosure claims from holder claims which "do not seek shareholder action." *Id.*

Indeed, in other contexts, Delaware courts have held that allegations of non-disclosure do not automatically make a claim direct. Where the essence of a claim is that the corporation was mismanaged, the fact that the purported mismanagement was not disclosed does alter the derivative nature of the claim. *See In re Syncor Int'l Corp. S'holders Litig.*, 857 A.2d 994, 998 (Del. Ch. 2004) (conclusion that claims were derivative was "not altered by the fact that, when Fu's misconduct was ultimately disclosed, an effect of that disclosure was to cause a reduction in the exchange ratio" paid to individual shareholders in merger); *J.P.*

Morgan Chase, 906 A.2d at 773 (affirming dismissal of nondisclosure claim that was brought directly because "'the damages allegedly flowing from the disclosure violation are exactly the same as those suffered by JPMC in the underlying claim'" and the injury was "'properly regarded as injury to the corporation'" (citation omitted)).

In short, Delaware cases uniformly support the conclusion that Plaintiffs have only stated a derivative injury because they are seeking recovery for the decline in the "actual value" of their stock as a result of the materialization of risks caused by purported mismanagement. Because Plaintiffs cannot identify any injury independent of the harm to Citigroup itself, their claims are derivative under the first factor of *Tooley.*

2. Only Citigroup would be entitled to recover damages for a decline in the "actual value" of Citigroup stock.

Considering *Tooley*'s second factor reinforces the conclusion that Plaintiffs' claims are derivative. In *Tooley*, the Delaware Supreme Court recognized that "a court should look to the nature of the wrong and to whom the relief *should* go." 845 A.2d at 1039 (emphasis added). Thus, the fact that Plaintiffs are seeking relief only for themselves is not dispositive. In *Manzo*, the court held that the claims were derivative even though the plaintiff sought damages only on behalf of a subset of Rite Aid shareholders. 2002 WL 31926606, at *5. *See also J.P. Morgan*, 906 A.2d at 819 ("Although the plaintiffs go to great lengths to define the class in a way that would allow them to argue for a direct class benefit, their effort to make the claim direct fails."). Similarly here, Plaintiffs' claims are derivative because the only relief that could possibly be awarded properly belongs to the corporation. *See Big Lots Stores Inc. v. Bain Capital Fund VII, LLC*, 922 A.2d 1169, 1179 (Del. Ch. 2006) (noting in direct claim, "no relief flows to the corporation").

Plaintiffs assert two theories for calculating damages. First, they seek the difference between the price at which they eventually sold their stock and the price they would have received had they sold their stock as they allegedly planned to in May 2007. (A.59 ¶ 172) But courts – both in and outside of Delaware – have dismissed similar damages theories because they are not cognizable. *See, e.g.*, *Manzo*, 2002 WL 31926606, at *5 (rejecting theory that plaintiff was entitled to lost opportunity or benefit of the bargain damages by being induced to hold her stock); *Starr Found. v. Am. Int'l Grp., Inc.*, 76 A.D.3d 25, 28 (1st Dep't 2010) (rejecting holder claims because it was "difficult to imagine" a more "'undeterminable and speculative'" measure of damages than what plaintiffs "might have realized from selling [their] shares ... under hypothetical market conditions"); *Chanoff v. United States Surgical Corp.*, 857 F. Supp. 1011, 1018 (D. Conn. 1994) ("the claims for damages based on the plaintiffs' failure to sell or hedge their stock are too speculative to be actionable").

Some courts have concluded that plaintiffs cannot recover such damages under any set of facts because it is not plausible that they could sell their stock before the market adjusted its pricing once the truth was disclosed. For instance, the Fifth Circuit affirmed dismissal of holder claims in *Crocker v. Federal Deposit Insurance Corp.* where the plaintiffs alleged that they could have "realiz[ed] a profit (or at least minimize[ed] their loss)" had they known the truth about the corporation's financial condition. 826 F.2d 347, 352 (5th Cir. 1987). The court reasoned that, had the truth "been released, the stock price would have immediately and precipitously fallen ... [and] there would have been no market for the stock at the artificially high price. Without such a market, the Crockers' envisioned 'profit opportunity' evaporates into hardly more than an illusion." *Id.* Other federal Courts of Appeals have applied this same reasoning and rejected damages theories that seek recovery based on the price at which holder plaintiffs purportedly could have sold. *See Rivers v. Wachovia Corp.*, 665 F.3d 610, 619 (4th Cir. 2011) (holder plaintiff "articulate[d] an incoherent theory of harm" because "the opportunity for profit which [plaintiff] claim[ed] he lost existed only due to the alleged misrepresentations that artificially inflated Wachovia's share price"); *Anderson v. Aon Corp.*, 674 F.3d 895, 897 (7th Cir. 2012); *Arent v. Distr. Sci., Inc.*, 975 F.2d 1370, 1374 (8th Cir. 1992).[5]

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[5] *See also Dloogatch v. Brincat*, 396 Ill. App. 3d 842, 853 (2009) (rejecting

(cont'd)

Plaintiffs' first damages theory suffers from the same flaws. Because Citigroup stock is sold in an efficient market, the market would have reacted to the "truth" about Citigroup's exposure to subprime assets as soon as it was disclosed. Thus, Plaintiffs would not have been able to avoid the decline in the value of their stock unless they were privy to non-public information. Despite Plaintiffs' allegation that Citigroup owed them a "specific duty" of disclosure separate from that owed to other investors, they had no entitlement to receive non-public information about Citigroup. (A.86 ¶ 257) Nor could they have traded on such information without risking violation of the federal securities laws themselves. *See Anderson v. Aon Corp.*, 614 F.3d 361, 367 (7th Cir. 2010) ("[P]ublic announcement of the truth would have made it impossible for Anderson to avoid the loss" without a "private revelation" and "trading on the basis of material nonpublic information violates federal securities laws"); *Arent*, 975 F.2d at 1374 (dismissing damages theory because "if everyone had known this adverse fact, then the stock's value would have reflected the adversity" and plaintiffs could have

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damages theory where plaintiff allegedly "suffered a loss when the market price of the stock fell after disclosure of the fraud" because "it would allow plaintiffs to benefit from 'the fraudulently inflated price of the stock when they neither purchased nor sold at that price"); *Arnlund v. Deloitte & Touche LLP*, 199 F. Supp. 2d 461, 487-88 (E.D. Va. 2002) ("[I]f the 'true facts' of HM's financial condition had been disclosed earlier, the same loss in share price would still have occurred, only a little earlier, thus the loss was not caused by the misrepresentation, but rather the truth.").

obtained the price they claimed "only if [they] were the only ones DSI told, so that they could have improperly traded on inside information").

Plaintiffs have attempted to overcome these flaws in their trading-based damages theory by insisting that they do not seek to profit from the inflation caused by the alleged fraud. (PB 40-42) Instead, Plaintiffs' claim that they would have been able to sell their stock at a purported "fraud-free" price of $51.59 had the truth been disclosed in May 2007. (PB 40) Other than citing an undisclosed "event study," Plaintiffs have offered no explanation for how they arrived at that "fraud-free" price. *See Chanoff*, 857 F. Supp. at 1018 (noting the "difficulty of quantifying the value of earlier disclosure," and holding that, because of that difficulty, "the actual calculation of such damages would be intractable at best"); *Starr*, 76 A.D.3d at 32 (rejecting contention that "some unspecified expert testimony would enable [plaintiff] to establish the effect on the market for AIG stock of earlier disclosure of the true risk of the CDS portfolio"). But even if Plaintiffs could support their contention that disclosing the truth in May 2007 would only have caused a decline to $51.59, they would be forced to concede that the further decline to $3.09 – which is what they are seeking – was caused by Citigroup's general decline, not by their reliance on misrepresentations. *See Starr*, 76 A.D.3d at 31("To the extent the Foundation argues that the ultimate drop in AIG's share price was greater than it otherwise would have been because general market conditions had worsened by the time the alleged misrepresentations were corrected, the loss was not related to the subject of the alleged misrepresentations and therefore was not proximately caused by them[.]").

In fact, Plaintiffs have conceded that their damages are based on Citigroup's overall decline in their appellate brief. In basing their damages on the difference between the supposed "fraud-free" price and the price at which they sold, they describe those losses as the decline in the "actual value" of Citigroup due to its exposure to subprime mortgages. (PB 44 ("The complaint alleges that Citigroup's stock price fell because of the materialization of the subprime risks....")) Any damages for this diminution in the "actual value" of Citigroup stock could only be recovered by Citigroup. *See J.P. Morgan*, 906 A.2d at 819 (remedy for "return of the 'proper interest' of JPMC" would go to corporation, not individual shareholders).

Plaintiffs' second theory for calculating damages leaves no doubt that the any cognizable recovery in this case would belong to Citigroup. Plaintiffs asked the District Court to award them damages based on the difference between the price of their stock at the time of their initial investment and the price at which they eventually sold it. (A.59 ¶ 173) But Plaintiffs have no independent entitlement to damages simply because their initial investment decreased in value. *See Dloogatch*, 396 Ill. App. 3d 842, 853 (2009) (dismissing similar theory of damages because "such a measure would have no causal relationship to the alleged misstatements"). Only Citigroup would be entitled to recover damages for a claim that management's decision to take on risk caused a decline in the value of Citigroup stock. *See Thornton v. Bernard Tech., Inc.*, No. 962-VCN, 2009 WL 426179, at *3 (Del. Ch. Feb. 20, 2009) (because plaintiffs "complain of quintessential director mismanagement ... any recovery would be for the benefit of the corporate entity"); *Dietrich*, 857 A.2d at 1027-28 ("any monetary recovery" for claims that directors breached duty in managing company "would properly belong to the corporation").

II. SOUND POLICY SUPPORTS THE CONCLUSION THAT HOLDER CLAIMS MAY ONLY BE BROUGHT DERIVATIVELY.

Allowing shareholders to assert holder claims directly would undermine Delaware's policy of restricting individual shareholders' ability to involve the corporation in expensive litigation to serve their own interests. *Tooley* itself recognized that "[d]etermining whether an action is derivative or direct ... has many legal consequences, some of which may have an expensive impact on the parties to the action." 845 A.2d at 1036.

Delaware has placed several constraints on shareholders who seek to sue for a corporate injury "to prevent the potentially disruptive effects of derivative litigation on the ability of a board of directors to direct the business and affairs of a corporation." *See Agostino,* 845 A.2d at 1117; *Joy v. North*, 692 F.2d 880, 887 (2d Cir. 1982) (recognizing potential harm to shareholders from "the threat of protracted discovery and litigation forcing settlement and payment of fees even where the underlying suit has modest merit").

First, in order to have standing to sue derivatively, a shareholder must have (i) held stock at the time of the alleged injury, and (ii) continued to hold stock throughout the course of the litigation. *See Lewis v. Anderson*, 477 A.2d 1040, 1046 (Del. 1984); 8 *Del. C.* § 327. The "contemporaneous ownership" rule "precludes plaintiffs from challenging a board decision that occurred before the plaintiffs' stock ownership arose." *See La. Mun. Police Emps. Ret. Sys. v. Crawford*, 918 A.2d 1172, 1184 (Del. Ch. 2007). The "continuous ownership" rule exists "to ensure that the plaintiff prosecuting a derivative action has an economic interest aligned with that of the corporation and an incentive to maximize the corporation's value." *Parfi Holding AB v. Mirror Image Internet, Inc.*, 954 A.2d 911, 939 (Del. Ch. 2008).

Second, Delaware law requires a derivative plaintiff to make a demand on the board of directors, asking them to bring suit. *See Spiegel v. Buntrock*, 571 A.2d 767, 773 (Del. 1990). Because of the "fundamental principle that the board of directors normally controls the corporation's actions and policies," the question of "[w]hether or not a corporation should bring a lawsuit is a question normally addressed to the directors' business judgment, for which reason shareholders normally lack the legal managerial power to bring a suit to enforce a corporate claim." *Levine v. Smith*, No. 8833, 1989 WL 150784, at *4 (Del. Ch. May 21, 1990), *aff'd*, 591 A.2d 194 (Del. 1991). Demand is therefore necessary "to afford the directors an opportunity to exercise their reasonable business judgment" before a shareholder may file suit on behalf of the corporation. *Kamen v. Kemper Fin. Servs.*, 500 U.S. 90, 96 (1991) (internal citation and quotation marks omitted). Imposing this requirement "give[s] the directors an opportunity to rectify the alleged wrong without the expense of a lawsuit, or if such lawsuit must be brought, to allow the corporation to control the litigation." *Robotti & Co., LLC v. Liddell*, No. 3128-VCN, 2010 WL 157474, at *12 (Del. Ch. Jan. 14, 2010).

Third, Delaware courts and federal courts applying Delaware law have imposed a heightened pleading standard in derivative cases to "deter costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion expressed solely in conclusory terms." *Grimes v. Donald*, 673 A.2d 1207, 1217 (Del. 1996).

Fourth, Delaware substantive corporation law precludes derivative plaintiffs from imposing the burden and expense of discovery on a corporation unless and until it can meet these threshold requirements. *See Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004).

Each of these limitations serves to "'to preserve the primacy of board decision making regarding legal claims belonging to the corporation.'" *In re Citigroup Inc. Derivative S'holder Litig.*, 964 A.2d 106, 120 (Del. Ch. 2009) (quoting *Am. Int'l Grp., Inc.*, 965 A.2d 763, 807-09 (Del. Ch. 2009)). Because these limitations are only imposed on derivative claims, "treating the action as primarily derivative under *Tooley* ... will serve the core Delaware public policies of promoting internal dispute resolution and ensuring that [Citigroup] has the first opportunity to address and control the claims." *Brinckerhoff v. Enbridge Energy Co., Inc.*, No. 5526-VCN, 2011 WL 4599654, at *6 (Del. Ch. Sept. 30, 2011) (internal quotation marks omitted), *aff'd*, 67 A.3d 369 (Del. 2013).

Furthermore, Delaware's policy for limiting shareholders' ability to impose expensive litigation on corporations is not protected by other state's common law regarding holder claims. A few states recognize the viability of holder claims despite their inherently speculative nature. *See, e.g.*, *Small v. Fritz Cos.*, 65 P.3d 1255, 1257 (Cal. 2003); *Holmes v. Grubman*, 691 S.E.2d 196, 199 (Ga. 2010); *Reisman v. KPMG Peat Marwick LLP*, 57 Mass. App. Ct. 100, 112 (2003); *Gutman v. Howard Sav. Bank*, 748 F. Supp. 254, 262 (D.N.J. 1990). Although these states require particularized pleading before allowing holder claims to proceed, that is not an adequate substitute for the limitations imposed by Delaware law. In these states, former shareholders would be able to sue for a corporate claim and directors would lose their authority to determine whether pursuit of corporate claims was in the best interests of the company and all shareholders. These procedural safeguards, as well as the restrictions on discovery, would vary from state to state. The reason why Delaware law applies to the direct versus derivative issue in the first place is to maintain certainty and predictability for corporations and their directors in matters involving the corporation's internal affairs. *See NatTel, LLC v. SAC Capital Advisors LLC*, 370 F. App'x 132, 134 (2d Cir. 2006). Delaware corporations such as Citigroup – and their underwriters and advisors—should not face greater risk that some states will allow shareholders or former shareholders to impose the burden of expensive and disruptive litigation upon them when Delaware law has given control over such litigation to the board of directors.

CONCLUSION

For all of the foregoing reasons, this Court should reverse the District Court's ruling that Plaintiffs' claim are not derivative under Delaware law.

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1. This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B) because this brief contains 6,805 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

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3. The text of the electronic brief, filed in accordance with Local Appellate Rule 31.1, is identical to the text in the paper copies.

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