IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

Defendants Below, Appellants,

v.

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

Plaintiffs Below, Appellees.

No. 641, 2015

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

BRIEF OF AMICUS CURIAE THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF APPELLANTS

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STATEMENT OF INTEREST OF THE AMICUS CURIAE

The Securities Industry and Financial Markets Association ("SIFMA") is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients, including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).[1]

SIFMA has an interest in the current proceeding because Plaintiffs-Appellees ("Plaintiffs") will 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 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 certified question: 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

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

therefore be subject to the protections that Delaware law provides in derivative suits and require any recovery to be paid to the corporation for the benefit of all stockholders.

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 stockholder or, as here, former stockholders. Allowing former holders of stock to assert directly on their own behalf claims that are based on injuries suffered by the corporation would disrupt the ability of directors of public corporations to manage the corporation's litigation rights and obtain recovery for corporate injury for the benefit of all current stockholders.

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 corporations' litigation rights, and will help investors to avoid the burden and expense of dubious, easily manufactured "holder" claims.

SUMMARY OF THE ARGUMENT

Plaintiffs are former stockholders of Citigroup who suffered losses when Citigroup declined in value as it gradually realized losses on its investments in subprime assets between May 2007 and March 2009. Plaintiffs seek damages that *derive* from the losses sustained by Citigroup. Nevertheless, Plaintiffs try to bootstrap their derivative losses into direct fraud claims by asserting that they continued to hold their shares in reliance on misrepresentations by the defendants. Most courts have been dubious of such "holder" fraud claims because of the ease with which such a claim can be manufactured in hindsight.[2] On this certified question, the Court is not asked to consider the viability of holder claims as a matter of common law fraud, but whether such claims are derivative under Delaware law because they seek redress for corporate harm. SIFMA, as *amicus curiae*, respectfully submits that both public policy and this Court's prior rulings compel the conclusion that Plaintiffs' "holder" claims are derivative.

Important policies served by derivative suits would be undermined if stockholders could readily transform their corporate losses into "holder" claims by alleging that they had a plan to sell their stock before a corporate crisis had devalued the company. Derivative actions ensure that recovery for a corporate

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[2] *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 751 (1975); *WM High Yield Fund v. O'Hanlon*, 2005 WL 6788446 (E.D. Pa. May 13, 2005).

injury is properly allocated to all shareholders and creditors in their appropriate order of priority. They reduce the risk of duplicative litigation and double recoveries. They also protect corporations from vexatious litigation through the demand and continuous ownership requirements.

Under the test set forth in *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), Plaintiffs' claims are derivative because Plaintiffs cannot show an injury independent of Citigroup. Even before *Tooley*, the Court recognized that an allegation "that false disclosures resulted in the corporation losing virtually all its equity seems obliquely to claim an injury to the corporation." *Malone v. Brincat*, 722 A.2d 5, 14 (Del. 1998). Relying on *Malone*, the Court of Chancery held that "holder" claims similar to those asserted here were derivative, and this Court affirmed that decision. *Manzo v. Rite Aid Corp.*, 2002 WL 31926606, at *1-2 (Del. Ch. Dec. 19, 2002), *aff'd*, 825 A.2d 239 (Del. 2003) (TABLE). Post-*Tooley*, the Court has continued to reject attempts to obtain individual relief for the same injury that a corporation would be entitled to recover in a derivative action. *See In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 771-74 (Del. 2006); *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008).

ARGUMENT

I. PUBLIC POLICY SUPPORTS THE CONCLUSION THAT "HOLDER" FRAUD CLAIMS MAY ONLY BE BROUGHT DERIVATIVELY.

Plaintiffs, who owned shares of Citigroup until March 2009, allege that they remained stockholders of Citigroup longer than they would have due to misleading statements by Citigroup management regarding the extent of Citigroup's exposure to risky subprime assets. According to Plaintiffs, their continued ownership of Citigroup stock caused them harm because, as these subprime risks were gradually realized, those weak assets caused a decline in the actual value of Citigroup, which was then reflected in Citigroup's stock price. (A14-A15, ¶¶ 7, 9) Although Plaintiffs style their claims as common law "holder" fraud claims, their losses are not based on any distortion in stock price as a result of the alleged fraud but rather stem from a decline in the value of Citigroup during the time that they were stockholders. This injury arising from the collapse in the value of subprime assets owned by Citigroup was suffered primarily *by Citigroup* and only indirectly by Plaintiffs.

As explained in Part II below, these claims are properly characterized as derivative suits under this Court's two-part test established in *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). Because the direct/derivative analysis under *Tooley* will be thoroughly briefed by the parties, SIFMA, as *amicus curiae*, first asks the Court to consider the important policies served by requiring "holder" claims to comply with the special procedures applied to derivative suits. Notably, while the application of the *Tooley* test can seem theoretical and academic, the consequences of this distinction are significant. Indeed, there are at least three important policies that are served by recognizing Plaintiffs' "holder" fraud claims as derivative claims.

First, "[b]ecause a derivative suit is being brought on behalf of the corporation, the recovery, if any, must go to the corporation." *Tooley*, 845 A.2d at 1036. As a result, the derivative suit "ensures that injury to a whole association [of investors] is adjudicated on behalf of that whole and not just for the benefit of the individuals who have undertaken to pursue the claims." *In re Cencom Cable Income Partners, L.P., Litig.*, 2000 WL 130629, at *4 (Del. Ch. Jan. 27, 2000). Allowing only the corporation to recover for corporate losses is critical to maintaining established priority to the corporation's assets. In other words, "[t]o permit proportionate individual recovery for damages to the corporation would in effect be a judicial determination to distribute corporate assets" to those select claimants only. *Distinguishing Between Direct and Derivative Shareholder Suits*, 110 U. Pa. L. Rev. 1147, 1148 (1962).

The derivative suit not only protects the rights of non-party stockholders, but it also serves the interests of creditors, who have higher-order rights to corporate assets. *See, e.g.*, *Case Fin., Inc. v. Alden*, 2009 WL 2581873, at *6 (Del. Ch. Aug. 21, 2009) (noting that a parent cannot assert directly a claim belonging to a subsidiary because "any damages recoverable by the subsidiary [must] be available not only to the shareholder-parent, as the residual claimant, but also the subsidiary's creditors").

The purported direct "holder" fraud claims asserted by Plaintiffs pose a significant threat to this well-functioning corporate-claims regime. For example, here, Citigroup's ownership of subprime assets damaged the company, which indirectly caused all of its stockholders to suffer losses. The traditional remedy for such losses – if any – is to pursue a derivative claim seeking to recover those corporate losses on behalf of the corporation.

Moreover, while in this instance Citigroup has recovered from its downturn suffered during the worst of the financial crisis and great recession, it is notable that "holder" claims are likely to arise after a corporation suffers catastrophic losses, which in some circumstances, could threaten insolvency. Thus, to allow stockholders to recharacterize their investment losses as "holder" fraud claims would give them an opportunity to "cut the line" and help themselves to corporate assets in an unfair manner during a corporate crisis.

Second, by requiring suits based on indirect losses suffered by stockholders to be brought as a single lawsuit, the derivative suit protects the defendants from duplicative litigation and possible double recoveries. One purpose of the derivative suit is that it ensures that claims seeking to recover for the same losses are heard together. As then-Vice Chancellor Strine observed, derivative suits "should be seen for what they are, a form of class action." *Parfi Holding AB v. Mirror Image Internet, Inc.*, 954 A.2d 911, 940 (Del. Ch. 2008). But unlike class actions, which are permissive in nature, a derivative suit provides greater protection because Delaware law "*require[s]* it be litigated once, for all." *Wells Fargo & Co. v. First Interstate Bancorp*, 1996 WL 32169, at *7 (Del. Ch. Jan. 18, 1996) (emphasis added). That not only protects the interests of non-party investors in the corporation, but it also protects the defendants from multiple lawsuits and possible double recoveries.

Third, the special procedures governing derivative suits protect Delaware corporations and their stockholders from abusive and vexatious litigation. *See Aronson v. Lewis*, 473 A.2d 805, 811-12 (Del. 1984). These protections include the demand requirement reflected in Court of Chancery Rule 23.1 and the continuous ownership rule enacted in Section 327 of the Delaware General Corporation Law. Because "holder" fraud claims can be so easily manipulated or manufactured,[3] these safeguards are well-suited to controlling such claims.

[3] *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747 (1975); *WM High Yield Fund v. O'Hanlon*, 2005 WL 6788446, at *13-14 (E.D. Pa. May 13, 2005).

II. PLAINTIFFS' HOLDER CLAIMS ARE DERIVATIVE CLAIMS UNDER THE *TOOLEY* STANDARD.

A. The *Tooley* Standard Applies To Plaintiffs' Claims

Plaintiffs have argued that the *Tooley* standard should not be extended beyond claims for breach of fiduciary duty under Delaware law. This argument is inconsistent with numerous Delaware cases.

The mere fact that Plaintiffs style their "holder" claims as fraud claims under Florida law rather than breach of fiduciary duty claims under Delaware law does not obviate the need to consider whether these stockholder claims are direct or derivative under *Tooley*. "Any claim belonging to the corporation may, in appropriate circumstances, be asserted in a derivative action, including claims that do – and claims that do not – involve corporate mismanagement or breach of fiduciary duty." *In re El Paso Pipeline Partners, L.P. Derivative Litig.*, 2015 WL 7758609 at * 15 (Dec. 2, 2015) (citations omitted).[4]

The case cited by Plaintiffs in support of this argument – *NAF Holdings, LLC v. Li Fung (Trading) Limited*, 118 A.3d 175 (Del. 2015) – stands for the proposition that where a parent corporation has a personal contractual right, then it can assert that contract right directly in its own name regardless of whether

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[4] *See also Midland Food Serv., LLC v. Castle Hill Holdings VI, LLC*, 792 A.2d 920, 931 (Del. Ch. 1999) ("[T]he premise of the plaintiffs' asserted exception – that claims based on theories such as reformation and unjust enrichment may not be brought derivatively – is incorrect.").

its damages are premised on an injury to a subsidiary. The outcome in *NAF* was driven by the presence of the parent company's distinct contract right, not by the absence of a fiduciary duty claim. Indeed, Vice Chancellor Laster recently endorsed this interpretation of *NAF*. *See In re El Paso Pipeline*, 2015 WL 7758609, at *12 ("Where the parent corporation possessed its own contractual cause of action, the parent could sue directly to enforce it."). Here, Plaintiffs are not asserting personal contract rights.

As a result, the Court should apply the *Tooley* test for distinguishing direct and derivative claims. *See Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). That 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. As explained below, both prongs of the *Tooley* standard strongly favor treating these "holder" claims as derivative.

B. The Alleged Injury Was Suffered By Citigroup.

In considering "who suffered the alleged harm (the corporation or the suing stockholders, individually)," the Court should look to the nature of the injury alleged, not the purported duty owed or the theory of liability pleaded. *See Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008) (citing *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 771-74 (Del. 2006)).

Here, Plaintiffs allege that they were harmed as a result of misleading statements regarding the extent of Citigroup's exposure to risky subprime assets, which risks were gradually realized, causing a decline in the value of Citigroup's stock. Although Plaintiffs style their claims as common law "holder" fraud claims – asserting that they were convinced to forgo an opportunity to sell their stock in reliance on the alleged misleading statements – they do not seek relief based on any distortion in stock price. Rather, they contend that, while they were stockholders, there was a decline in the actual value of Citigroup, and they seek to recoup that drop in the actual value of Citigroup.

On these pleaded facts, Plaintiffs cannot, as they *must*, "prevail without showing an injury to the corporation." *Tooley*, 845 A.2d at 1039. Rather, their theory of harm is wholly dependent on damage to Citigroup that Plaintiffs suffered only indirectly. This independent injury requirement was not eliminated by *Tooley* but merely clarified. *Tooley* explains that the injury must be distinct from a corporate injury, but it need not be a "special injury" distinct from injuries suffered by all other stockholders. *See id.*

For example, in cases following *Tooley*, this Court has continued to emphasize that stockholders must state an independent injury to maintain a direct claim. *See Feldman*, 951 A.2d at 733 (affirming dismissal of claims as derivative because the harm was not "separate and distinct from the alleged harm to the

Company"); *J.P. Morgan*, 906 A.2d at 770, 774 (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)).

Specifically, in *J.P. Morgan,* the Court held that individual stockholders should not be able to pursue individual relief for an alleged disclosure violation when they suffered an injury only because they continued to hold their shares at the time the corporation's value diminished. *See* 906 A.2d at 770, 774. The plaintiff stockholders alleged that they were entitled to pursue direct claims for individual recovery of damages based on purported misstatements in a proxy statement, which induced them to approve an issuance of stock at an unfair discount. *Id.* at 768. Because the only recovery plaintiffs sought for the disclosure violation was the unfair discount, and that harm was the same harm to the corporation itself, the Court held that plaintiffs' claims were derivative. *Id.* at 772-73. The Court explicitly rejected the argument that plaintiffs could be "entitled to recover the identical damages on their disclosure claim, that the corporation would be entitled to recover on its underlying (derivative) claim." *Id.* Thus, if the disclosure claim were to be brought for those damages, it would have to be asserted derivatively. *Id.* at 770.

The Court's concerns in *J.P. Morgan* that plaintiffs be prohibited from artfully attributing corporate damages to an alleged individual injury were echoed in *Feldman*. In that case, the plaintiff alleged that directors breached their fiduciary duties by not reconsidering the validity of previously issued stock options before approving a merger agreement. *Feldman*, 951 A.2d at 730. Because the only harm plaintiff alleged was "exactly the same that was allegedly caused by the invalidity of the Challenged Stock Options in the first place," this Court held that plaintiff's claims were derivative. *Id.* at 733.

In both *J.P. Morgan* and *Feldman*, the Court endorsed the Court of Chancery's concern that allowing plaintiffs to recast their claims creates the risk of duplicative recovery for a single injury that properly belongs to the corporation. *J.P. Morgan,* 906 A.2d at 826 ("'How then could the same directors ever be liable to pay actual compensatory damages to both the corporation and the class for the same injury? The answer … is that they could not.'") (quoting *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808 (Del. Ch. 2005)); *Feldman*, 951 A.2d at 733 (endorsing the trial court's observation that plaintiff's "creative attempt to recast the derivative claim for dilution in Count V, by alleging the same fundamental harm in a slightly different way in Count XIII, is disfavored").

Moreover, SIFMA respectfully submits that the derivative nature of "holder" claims was addressed by this Court, albeit pre-*Tooley,* when the Court affirmed the Court of Chancery's decision in *Manzo v. Rite Aid Corp.*, 2002 WL 31926606, at *1-2 (Del. Ch. Dec. 19, 2002), *aff'd*, 825 A.2d 239 (Del. 2003)

(TABLE). In *Manzo*, Chancellor Chandler held that a plaintiff could not pursue direct claims for the "poor rate of return on her Rite Aid shares" or the "return she *could* have earned had she invested elsewhere." 2002 WL 31926606, at *5. The fact that the plaintiff based her entitlement to damages on allegations that she "was deprived of accurate information on which to base investment decisions" did not alter the conclusion that she was seeking recovery for a derivative injury. *Id.*

Manzo is still good law because *Tooley* did not radically change the Delaware standard for identifying derivative claims. Rather, *Tooley* merely gave courts a better analytical tool for reaching the same results reflected in the pre-*Tooley* precedent. *See In re El Paso Pipeline*, 2015 WL 7758609, at *19 ("It is true that *Tooley* discarded the term 'special injury,' but *Tooley* did not overrule the results in the cases that used that term…."). The Second Circuit believed that Delaware cases decided after *Tooley* were in tension with *Tooley*'s rejection of the "special injury" test because they employ language harking back to the question of whether the plaintiff has identified "some individualized injury not suffered by all of the stockholders at large." (Appellants' Opening Brief, Ex. A at 17, quoting *Feldman*, 951 A.2d at 733.) But *Tooley* did not reject inquiry into the indirect nature of the plaintiffs' injury. It merely rejected the argument that "if all of the stockholders held the same right, and if all of the stockholders were injured equally, then the claim should be regarded as derivative." *In re El Paso Pipeline*, 2015 WL

7758609, at *19. Here, the Court is not asked to conclude that Plaintiffs' claims are derivative merely because all stockholders were affected equally. Rather, the claims are derivative claims because Plaintiffs' injury is entirely dependent upon, and inseparable from, the harm suffered by Citigroup when its corporate assets declined in value.

In short, Plaintiffs' injury is no different than the injuries asserted in *J.P. Morgan*, *Feldman*, and *Manzo*. The reason why Plaintiffs continued to hold their stock does not change the fact that the injury they suffered must be *derived* from the primary and direct injury to Citigroup.

C. Plaintiffs' Damages Theories Would Support An Award To Citigroup.

Tooley's second prong considers "who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" 845 A.2d at 1033. "Holder" claims are derivative under this test as well.

Unlike the typical securities fraud plaintiff, Plaintiffs do not seek to recover based on an artificially distorted stock price. Instead, their primary method for calculating damages seeks to recover the supposed "fraud-free" price that they claim they could have obtained in May 2007. (A55-A56, ¶¶ 171-72) Plaintiffs have thus detached their damages from any distortion created by the alleged fraud and instead request damages based on a decline in the *actual value* of their stock due to a decline in the *actual value* of Citigroup. They allege that Citigroup's drop in value occurred because its managers "fail[ed] to properly monitor and manage subprime risk" (A39, ¶ 96), underwrote loans of poor quality (A41, ¶¶ 126-27), failed to calculate loss reserves correctly (A48, ¶ 135), and failed to perform proper risk assessments (A53-A54, ¶¶ 162-68). But 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 Techs., Inc.*, 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"); *Dieterich v. Harrer*, 857 A.2d 1017, 1027-28 (Del. Ch. 2004) ("any monetary recovery" for claims that directors breached duty in managing company "would properly belong to the corporation").

Plaintiffs propose a second method for calculating damages that leaves no doubt that the injury for which they seek redress was an injury to Citigroup and the damages should therefore flow to Citigroup. They have asked the federal court to award them damages based on the difference between the price of their stock at the time of the initial investment and the price at which they eventually sold it. (A56, ¶ 173) But Plaintiffs have no independent entitlement to damages simply because an initial investment in Citigroup decreased in value. Such damages properly belong to the corporation, which further confirms that the claim is derivative.

CONCLUSION

For all of the foregoing reasons, the Court should answer the certified question by determining that Plaintiffs' claims, as alleged, are derivative.

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Respectfully submitted,

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