EFiled: Sep 25 2017 12:05PM EDT
Filing ID 61156171
Case Number 230,2017

IN THE SUPREME COURT OF THE STATE OF DELAWARE

WALTER E. RYAN, JR., Plaintiff-Below, Appellant v. ALAN S. ARMSTRONG, JOSEPH R. CLEVELAND, KATHLEEN B. COOPER, JOHN A. HAGG, JUANITA H. HINSHAW, RALPH IZZO, FRANK T. MACINNIS, ERIC W. MANDELBLATT, KEITH A. MEISTER, STEVEN W. NANCE, MURRAY D. SMITH, JANICE D. STONEY and LAURA A. SUGG, Defendants-Below, Appellees, and THE WILLIAMS COMPANIES, INC., Nominal Defendant-Below, Appellee	)	No. 230, 2017 Court below: Court of Chancery C.A. No. 12717-VCG **PUBLIC REDACTED VERSION DATED: SEPT. 25, 2017**

APPELLANT'S REPLY BRIEF

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INTRODUCTION

Nothing in Defendants' Answering Brief undermines the reasonable inference that the WPZ Acquisition was defensive in nature, and that the deal was primarily or solely driven by motives of entrenchment, excusing presuit demand under the second prong of *Aronson.* Defendants' three arguments to the contrary are without merit.

First, Defendants' argument that *Unocal* and *Revlon* are irrelevant in cases seeking only monetary damages is simply wrong. This Court's decision in *RBC Capital Markets, LLC v. Jervis*,[1] which post-dates both *Cornerstone* [2] and *Corwin*[3] demonstrates this point.

Second, Defendants' identification of alternative justifications for the WPZ Acquisition does not undermine the reasonable inference that the deal was *designed* as a defensive device. Indeed, the very point of *Unocal*'s enhanced scrutiny is to "smoke out" the actual objective motivating challenged conduct so that "flimsy pretense stands a greater chance of being revealed."[4] Defendants' arguments ignore the Complaint's particularized allegations that Williams created

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[1] 129 A.3d 816 (Del. 2015).

[2] *In re Cornerstone Therapeutics, Inc. Stockholder Litig.*, 115 A.3d 1173 (Del. 2015)

[3] *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015).

[4] *Mercier v. Inter-Tel (Delaware), Inc.*, 929 A.2d 786, 807 (Del. Ch. 2007).

and operated in the dual HoldCo/MLP structure for over a decade,[5] reaffirmed its commitment to the structure in the months preceding ETE's indication of interest,[6] that the elimination of the HoldCo/MLP structure would deter ETE's interest in a deal,[7] and that Defendants only started looking into acquiring WPZ shortly after ETE's CFO reached out to Williams's investment banker to discuss a deal.[8] Nothing in Defendants' alternative explanations refutes the reasonable inference that the WPZ Acquisition was designed to be defensive. And crucially, having failed to rebut this reasonable inference, Defendants fail to identify ***any*** legitimate corporate interests that were protected through the acquisition of WPZ, leaving the inference that the *sole* motivation was entrenchment.

Finally, Defendants' argument that Rule 15(aaa), *res judicata*, or the doctrine of claim splitting bar this Derivative Action is misplaced. Rule 15(aaa) only applies to "amendments" of pleadings. The assertion of derivative claims on behalf of Williams did not constitute an amendment of direct claims asserted individually and on behalf of Williams's stockholders. This Derivative Action also

[5] A19¶38.

[6] A19¶39

[7] *See* A18-19¶¶59,100.

[8] A22¶48.

is not barred by the doctrines of *res judicata* or claim splitting because the Direct Action did not resolve any claims of the Company, and Delaware law does not require a stockholder to pursue direct and derivative claims simultaneously. In addition, the termination of the Williams-ETE merger after the filing of the Direct Action provides a valid reason for Plaintiff's having filed a separate derivative action.

SUMMARY OF ARGUMENT

1. Plaintiff incorporates the Summary of Argument in its Opening Brief with respect to the two issues raised therein.

2. Plaintiff denies paragraph 2 of Defendants' Summary of Argument. Even in cases seeking only damages, particularized allegations raising a reasonable inference that a board took defensive action in response to a perceived threat to control, but without protecting any legitimate corporate or stockholder interests, raise a reasonable doubt that the conduct was the product of the valid exercise of business judgment excusing demand under the second prong of *Aronson*. *Unocal*, like the enhanced scrutiny of *Revlon*, remains relevant because it provides the governing standard for reviewing whether a complaint's allegations are sufficient to raise a doubt that corporate directors complied with their fiduciary duties.

3. Plaintiff denies paragraph 3 of Defendants' Summary of Argument. The commencement of a derivative action does not "amend" any claims asserted in a direct action, rendering Rule 15(aaa) irrelevant. *Res judicata* and the doctrine of claim splitting also do not apply. Direct actions, brought on behalf of a class of stockholders, and derivative actions, brought on behalf of a corporation itself, are fundamentally different. In addition, the termination of the Williams-ETE merger provides a valid reason for Plaintiff's filing the Derivative Action.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN FINDING THAT PRESUIT DEMAND WAS NOT EXCUSED

A. DEMAND IS EXCUSED WHERE A COMPLAINT CONTAINS WELL-PLEADED ALLEGATIONS THAT DEFENSIVE MEASURES WERE THE PRODUCT OF MOTIVES OF ENTRENCHMENT

Defendants' argument that "*Unocal* does not apply because Plaintiff seeks only damages"[9] is wrong. Under the second prong of *Aronson*, presuit demand is excused if the complaint's allegations are sufficient to raise a reasonable doubt that the challenged corporate conduct was the product of the valid exercise of business judgment. *Unocal* is relevant, not because it establishes a basis to impose financial liability, but because it provides the correct analysis under Delaware law to evaluate whether a corporate board's adoption of a defensive measure was a valid exercise of business judgment. The concerns that justify the enhanced scrutiny required by *Unocal* exist whether the complaint seeks injunctive relief or money damages. Whether corporate directors are exculpated from money damages under a Section 102(b)(7) charter provision is a different inquiry. But where the enhanced scrutiny required under *Unocal* provides a reasonable basis to infer a

[9] Ans. Br. at 16.

defensive measure was adopted for purposes of entrenchment, presuit demand is excused under the second prong of *Aronson*.[10]

Defendants' argument is based on certain language in *In re Cornerstone Therapeutics, Inc. Stockholder Litigation*[11] and *Corwin v. KKR Financial Holdings LLC*.[12] But this Court's later decision in *RBC Capital Markets, LLC v. Jervis*[13] amply demonstrates why Defendants' reliance is misplaced.

Cornerstone held that a plaintiff seeking only monetary damages must plead non-exculpated claims "regardless of the underlying standard of review for the board's conduct -- be it *Revlon*, *Unocal*, the entire fairness standard or the business judgment rule."[14] Four months later, *Corwin* observed: "*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing. They were not tools designed with post-closing money damages claims in mind."[15] Neither decision involved a question of demand futility. And neither decision held

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[10] *See Pogostin v. Rice*, 480 A.2d 619, 627 (Del. 1984).

[11] 115 A.3d 1173.

[12] 125 A.3d 304.

[13] 129 A.3d 816.

[14] 115 A.3d at 1175-76.

[15] 125 A.3d at 312.

that allegations triggering enhanced scrutiny under Delaware law are *irrelevant* for purposes of determining whether a corporate director breached his or her fiduciary duty in the first place. Rather, both *Cornerstone* and *Corwin* recognize that allegations implicating enhanced scrutiny required under Delaware law are not necessarily sufficient to state a non-exculpated claim. The Court in *Corwin* explained: "[T]he standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom*, and with the prevalence of exculpatory charter provisions, due care liability is rarely even available."[16] But as *Cornerstone* explained, whether corporate directors are exculpated under Section 102(b)(7) charter provisions does not change the standards for evaluating director conduct under Delaware law.[17]

This Court's decision in *RBC* – issued shortly after *Corwin* – demonstrates this point. In *RBC*, the Court of Chancery had found that in a company sale, the target's financial advisor, RBC, had aided and abetted the company's directors' breaches of fiduciary duty. On appeal, RBC challenged the existence of a predicate breach of fiduciary duty by the board. Among other issues, RBC argued, as Defendants do here, that enhanced scrutiny – in that case under *Revlon* – "exists

[16] *Id.*

[17] 115 A.3d at 1181.

to determine whether plaintiff stockholders should receive pre-closing injunctive relief, but it cannot be used to establish a breach of fiduciary duty that warrants post-closing damages."[18] This Court rejected RBC's argument:

> When disinterested directors themselves face liability, the law, for policy reasons, requires that they be deemed to have acted with gross negligence in order to sustain a monetary judgment against them. That does not mean, however, that if they were subject to *Revlon* duties, and their conduct was unreasonable, that there was not a breach of fiduciary duty… We agree with the trial court that the individual defendants breached their fiduciary duties by engaging in conduct that fell outside the range of reasonableness. …[19]

This means where Delaware law requires enhanced scrutiny of the directors' conduct, that governing standard remains applicable in actions seeking monetary relief. Whether the directors are exculpated under a Section 102(b)(7) charter provision is a different inquiry, but does not change the governing standard under which the directors' conduct is reviewed.

"The idea that boards may be acting in their own self-interest to perpetuate themselves in office is, in and of itself, the 'omnipresent specter' justifying enhanced judicial scrutiny."[20] This remains true regardless of whether a subsequently filed complaint seeks injunctive relief or only monetary damages.

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[18] 129 A.3d at 857.

[19] *Id.*

[20] *Air Prods. and Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 94 (Del. Ch. 2011).

Because the concerns underlying *Unocal* focus on director conduct, not the plaintiff's ultimate claim for relief, the nature of the relief sought should not change the analysis. "So long as the plaintiff states a claim implicating the heightened scrutiny required by *Unocal*, demand has been excused under the [*Aronson*] demand excusal test." [21] Where, as here, the allegations are sufficient to raise an inference that corporate directors adopted defensive measures for purposes of entrenchment, such allegations under *Unocal* remove the alleged conduct from the protections of the business judgment rule, and excuse presuit demand under the second prong of *Aronson.*[22]

[21] *Gaylord Container Corp. S'holders Litig.*, 747 A.2d 71, 75-85 (Del. Ch. 1999) (quoted in *In re EZcorp Inc. Consulting Agr. Deriv. Litig.*, 2016 WL 301245, at *29 (Del. Ch. Jan. 25, 2016)).

[22] Defendants argue that Plaintiff cannot establish demand futility based on the theory that only Armstrong approved the WPZ Acquisition to entrench himself. Ans. Br. at 33-34 & 34n.10. But Plaintiff never argued the contrary. In the portion of the brief cited by Defendants, Plaintiff argued that demand could be excused even if only Armstrong could be held liable for a bad-faith breach of duty, if the other directors had acted with a motive of entrenching themselves. Because, as discussed below, Plaintiff has raised an inference that at least half of the members of the Demand Board acted with entrenchment motives, demand is excused. And because, for the reasons set forth in section II below, the Direct Action and the Derivative Action are fundamentally different, Defendants' argument that the appropriate board composition to consider for purposes of demand futility is that in place at the time the Direct Action was filed (Ans. Br. at 23n.3) is baseless.

B. THE ALLEGATIONS OF THE COMPLAINT SUPPORT AN INFERENCE THAT THE WPZ ACQUISITION WAS DEFENSIVE AND SOLELY OR PRIMARILY MOTIVATED BY ENTRENCHMENT

1. The Court of Chancery Correctly Found That The Complaint Adequately Alleged That The WPZ Acquisition Was Defensive

The Court of Chancery found that Plaintiff had pleaded sufficient facts to raise a reasonable inference that "the WPZ Acquisition was a defensive measure in response to a threat, and so triggers *Unocal* enhanced scrutiny."[23] Defendants argue that this finding was error,[24] but none of their arguments undermine the reasonableness of the Court's conclusion.

First, the delay between ETE's initial overtures in February 2014 and the board's first consideration of the WPZ Acquisition in December 2014 does not undermine the defensive nature of the WPZ Acquisition. After operating in a dual HoldCo/MLP structure for over a decade, the Williams Board first contemplated eliminating this structure and acquiring WPZ just a month after ETE's CFO contacted Williams's banker, Barclays, about a possible acquisition.[25] Defendants' execution of the WPZ Acquisition came after ETE had made repeated efforts to

[23] Op. at 24.

[24] Ans. Br. at 25.

[25] A22¶48.

engage the Williams Board in substantive discussions. As ETE wrote in its June 2015 press release: "Williams's management has inexplicably ignored ETE's efforts to engage in a discussion with Williams regarding a transaction that presents a compelling value proposition for its stockholders."[26] There is more than a legitimate basis to infer that the Williams Board implemented the WPZ Acquisition in response to ETE's repeated overtures.[27]

Second, that ETE had not made any monetary offer prior to the Board's entering into the WPZ Acquisition[28] does not undermine the defensive nature of the WPZ Acquisition. There is *no requirement* that ETE was required to have made a formal offer to acquire Williams before the WPZ Acquisition can be deemed defensive in nature. Rather, the defensive nature can be inferred from the facts pled. In *Ebix*, for example, the Court held that "[t]he [complaint] establishes a factual chronology that, viewed in a light most favorable to Plaintiffs, supports Plaintiffs' contention that the Board adopted [challenged bylaws] to stave off" an

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[26] A33¶79.

[27] *See*, *e.g.*, *Third Point LLC v. Ruprecht*, 2014 WL 1922029, at *17 (Del. Ch. May 2, 2014) (*Unocal* applied where investor's stock purchases posed threat of creeping takeover without formal indication of interest); *Yucaipa American Alliance Fund v. Riggio*, 1 A.3d 310, 346-50 (Del. Ch. 2010) (*Unocal* applied where investor never made formal or informal offer for company and "disclaimed willingness or intent" to buy company).

[28] Ans. Br. at 23.

activist stockholder who had stated an intention to launch, but had not yet commenced, a proxy contest.[29] The fact that ETE had not indicated a possible price does undermine the legitimacy of any defensive measures implemented by the Williams Board,[30] but it does not undermine the defensive design of the acquisition itself.

Third, the fact that Williams eventually entered into a merger agreement with ETE and later sued ETE to go forward with the merger[31] does not rebut the inference that the WPZ Acquisition was defensive in nature when it was adopted.[32] Indeed, the fact that the WPZ Acquisition had to be terminated in order for

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[29] *In re Ebix Inc. Stockholder Litig.*, 2016 WL 208402, at *19 (Del. Ch. Jan. 15, 2016).

[30] *See, e.g.*, *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 35 (Del. Ch. 2010) (striking down defensive measure where "defendants failed to prove that they acted to protect or defend a legitimate corporate interest").

[31] Ans. Br. at 22-23.

[32] The defensive motivation behind the WPZ Acquisition is confirmed by the fact that, after termination of the ETE Merger, instead of revisiting the acquisition of WPZ, Williams reinforced its commitment to a dual HoldCo/MLP structure by purchasing more than $2 billion of WPZ limited partnership units, and permanently waiving the incentive distribution rights. *See* Williams Form 10K for the period ending December 31, 2016 at 4 (*available at*: https://www.sec.gov/Archives/edgar/data/107263/000010726317000003/wmb_20161231x10k.htm). This Court may take judicial notice of documents filed with the U.S. Securities and Exchange Commission. *See Hazout v. Tsang Mun Ting*, 134 A.3d 274, 280 n.13 (Del. 2016).

Williams to enter into the merger agreement with ETE *demonstrates* the defensive impact of the WPZ Acquisition.[33]

2. Defendants Fail To Identify Any Legitimate Corporate Interest Protected By The WPZ Acquisition, Leaving The Unavoidable Conclusion That The Sole or Primary Motivation Was Entrenchment

Because the Complaint raised a reasonable inference that the WPZ Acquisition was defensive, it was incumbent on Defendants to identify *some* legitimate threat to corporate operations or policy that could justify it.[34] Defendants ignore this requirement entirely, because they cannot satisfy it. After demonstrating that ETE's expressions of interests did not present any legitimate threat to corporate policy or effectiveness,[35] Plaintiffs' opening brief asked a simple question, "If the WPZ Acquisition was not designed to protect stockholders

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[33] Similarly, that two other parties made offers to acquire Williams that were not conditioned on termination of the WPZ Acquisition does not undermine the inference that the WPZ Acquisition was defensive. These two parties indicated that they would be interested in a merger approximately two-and-a-half months after the Board approved the WPZ Acquisition. A384-85. The fact that these two parties were willing to merge with Williams – on economic terms that are not disclosed in the proxy (*id.*) – without termination of the WPZ Acquisition is irrelevant to the Board's motivations months earlier.

[34] *See Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1375 (Del. 1995) ("The first aspect of the *Unocal* burden … required the [board] to demonstrate that … it determined … that [potential offer] presented a threat to [the company] that warranted a defensive response.").

[35] Op. Br. at 29-32.

from an inadequate or coercive bid, or to protect some existing corporate policy or strategy, what was it designed to do?"[36] Defendants have no answer. Because the WPZ Acquisition did not protect any legitimate corporate interests, there is a compelling inference that the ***sole*** motivation of the WPZ Acquisition was entrenchment. And nothing in Defendants' responsive brief rebuts this point.

Turning *Unocal* on its head, Defendants argue that "Plaintiff undercuts his argument of entrenchment by asserting repeatedly in his brief … that ETE 'was no threat to corporate policy or effectiveness'."[37] But "*Unocal* applies whenever a board perceives a threat to control and takes defensive measures in response to the threat."[38] Once *Unocal* has been triggered, "to meet their burden under the first prong of *Unocal*, defendants must actually articulate some legitimate threat to corporate policy and effectiveness."[39] Although, as the Court of Chancery recognized, ETE posed a threat to Defendants' control over the Company,[40] it did

[36] *See* Op. Br. at 32

[37] Ans. Br. at 24.

[38] *Stroud v. Grace*, 606 A.2d 75, 82 (Del. 1992).

[39] *Airgas*, 16 A.3d at 92.

[40] Op. at 23-24.

not pose any "threat to corporate policy and effectiveness" that would justify entering into the WPZ Acquisition as a defensive measure in response.[41]

Williams utilized a dual HoldCo/MLP structure for nearly a decade, and the Board only began considering eliminating the dual structure the month after ETE renewed its acquisition overtures.[42] And despite Barclays's repeated suggestions that the Board "[d]efer ultimate decision to later date [redacted]," the Board implemented the WPZ Acquisition against this advice.[43] The supposed benefits that Barclays identified would have existed throughout the decade that Williams utilized the dual HoldCo/MLP structure, and do not explain the timing. This is just the type of

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[41] The cases that Defendants cite are inapposite because none of them involved any meaningful threat to control. *Kahn v. Roberts*, 679 A.2d 460, 464 (Del. 1996) ("[U]nder no objective view of the facts could a reasonable threat to corporate control have existed."); *Grobow v. Perot*, 539 A.2d 180, 188 (Del. 1988) ("Plaintiffs also do not plead any facts tending to show that the GM directors' positions were actually threatened by Perot. … Plaintiffs merely argue that Perot's public criticism of GM management could cause the directors embarrassment sufficient to lead to their removal from office."); *Ryan v. Gursahaney*, 2015 WL 1915911, at *7 (Del. Ch. Apr. 28, 2015) (allegations regarding threat to control "tenuous at best" and speculative).

[42] Op. Br. at 33.

[43] *Id.*

situation where *Unocal* can be used to "smoke out the actual objective supposedly motivating [action]" and reveal "flimsy pretense."[44]

Finally, the inclusion of the termination fee and the force-the-vote provision here make no sense *other* than for purposes of entrenchment. The purpose of a termination fee is to protect a target company from the opportunity costs that could arise from a failed bid. But because Williams owned a majority of WPZ limited partner units, WPZ would not have been able to engage in a transaction with anyone other than Williams without Williams's approval. Thus, a merger with Williams presented no possibility of lost opportunities to WPZ against which WPZ needed protection. Similarly, the force-the-vote provision was unnecessary because Williams, through its ownership of a majority of WPZ limited partner units, could simply have voted down the WPZ Acquisition on the WPZ side. Allowing WPZ to force the Williams's stockholders to vote on the deal, even if the Williams Board could unilaterally terminate it by voting its WPZ units against the transaction, suggests that this provision was only included to inject delay and expense into the termination of the WPZ Acquisition further dissuading ETE from attempting to acquire Williams.

[44] *Mercier*, 929 A.2d at 807.

Where directors act "for the sole or primary purpose of perpetuating themselves in office," demand is excused.[45] The Court of Chancery correctly recognized that the Complaint raised a reasonable inference that the WPZ Acquisition was defensive, but neither the Court of Chancery nor Defendants here can identify any legitimate corporate interests being protected. The WPZ Acquisition did not protect against a coercive or inadequate offer (because ETE had not suggested terms or a price), and did not protect any existing corporate policy (and in fact represented a fundamental *change* in the HoldCo/MLP structure that Williams adopted over a decade earlier). Because Defendants have not, and cannot, identify any legitimate corporate interest protected through defensively adopting the WPZ Acquisition, there is a strong inference that Williams entered into the WPZ Acquisition for the sole or primary purpose of entrenchment, thus excusing presuit demand.

[45] *Pogostin*, 480 A.2d at 627.

II. PLAINTIFF'S DERIVATIVE COMPLAINT DOES NOT VIOLATE RULE 15(aaa) OR DELAWARE'S DOCTRINES OF *RES JUDICATA* OR CLAIM SPLITTING.

A. RULE 15(AAA) DOES NOT PRECLUDE THE DERIVATIVE ACTION

Defendants' reliance on Section 15(aaa) is misplaced. By its terms, Rule 15(aaa) applies only to amending claims: "[A] party that wishes to respond to a motion to dismiss under Rules 12(b)(6) or 23.1 by amending its pleading must file an amended complaint, or a motion to amend in conformity with this Rule, no later than the time such party's answering brief in response to either of the foregoing motions is due to be filed."

First, the commencement of a derivative action does not constitute an "amendment" of claims asserted individually by a stockholder or directly on behalf of a class. The viability of Plaintiff's direct claim rose, or fell, based on the merits of the allegations in the operative complaint in the Direct Action. Plaintiff's assertion of derivative claims in this case did not change the claims in the Direct Action at all. Characterizing the assertion of a derivative claim as an "amendment" of a direct claim is also contrary to Delaware law. If the filing of a derivative claim was an "amendment" of a direct claim, the filing of a class action would toll

derivative claims arising from the same facts.[46] But Delaware law is to the contrary. In *Wolst v. Monster Beverage Corp.*,[47] the Court "decline[d] to extend the rationale of *American Pipe*, which protects stockholders' direct claims, to derivative claims that stockholders might assert on behalf of the corporation."[48] Because the filing of this action was not an "amendment" of the claims asserted in the Direct Action, Rule 15(aaa) did not apply.

Second, Defendants have cited no case law – and Plaintiff has found none – suggesting that Rule 15(aaa) precludes a plaintiff from pursuing direct claims and derivative claims in separately filed actions. Rule 15(aaa) requires that Rule 41 "shall be construed so as to give effect to this subsection (aaa)." But, as Defendants' acknowledge,[49] that provision was added in response to *Stern v. LF Capital Partners, LLC*,[50] where the plaintiff attempted an end-run around Rule 15(aaa) by dismissing his derivative complaint without prejudice and then filing a

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[46] *See*, *e.g.*, Ct. Ch. R. 15(c) (Relation back of amendments).

[47] 2014 WL 4966139 (Del. Ch. Oct. 3, 2014); *see also Krinsk v. Fund Asset Mgmt., Inc.*, 1986 WL 205, at *3 (S.D.N.Y. May 9, 1986) (holding that claims by individual investors against investment advisors under Section 36(b) of the Investment Company Act of 1940 did not toll representative actions asserted under the same statute on behalf of the relevant fund itself).

[48] 2014 WL 4966139, at *2.

[49] Ans. Br. at 37.

[50] 820 A.2d 1143 (Del. Ch. 2003).

new complaint asserting ***the same derivative claim*** but with more detailed allegations of which he was aware prior to responding to the motion to dismiss in the earlier action.[51] *Stern* did not involve the question of whether a stockholder could assert direct and derivative claims in separate actions. Here, Plaintiff dismissed his complaint in the Direct Action with prejudice as to himself, and did not use a voluntary dismissal to end-run Rule 15(aaa) to file a better pleaded direct claim.

B. *RES JUDICATA* AND CLAIM SPLITTING DO NOT APPLY

Res judicata and claim splitting do not apply where, as here, a plaintiff asserts separate direct and derivative actions. But even if the doctrine of claim splitting could apply, the termination of the ETE-Williams merger and this Court's *El Paso* decision constituted changed circumstances that justify the procedural path that Plaintiff undertook.

In *Kossel v. Ashton Condominium Association, Inc.*,[52] this Court explained that the related doctrines of claim splitting and *res judicata* only bar a second

[51] *Stern*, 820 A.2d at 1144.

[52] 637 A.2d 827 (Del. 1994) (TABLE).

action upon the same matter "by the same party or his privies."[53] Stockholders are not in privity with the corporation for purposes of prosecuting their own claims.[54] The direct claim asserted by Plaintiff in his capacity as a stockholder is not the same claim that Williams has against Defendants.[55]

In *Carlton Investments v TLC Beatrice International Holdings, Inc.*,[56] the Court of Chancery found that a derivative action could go forward despite an earlier-filed direct action brought by the same plaintiff. In deciding that the derivative action could proceed, the Court noted: "The present [derivative] case is fundamentally different from the pending New York [direct] litigation because this

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[53] *Kossel*, 637 A.2d at *2 (quoting *Epstein v. Chatham Park, Inc.*, 153 A.2d 180, 184 (Del. Super. 1959)).

[54] *Grunstein v. Silva*, 2011 WL 378782, at *8 (Del. Ch. Jan. 31, 2011) (rejecting defendants' argument that "[stockholder-plaintiff] is in privity with [corporation] because he controls it as a closely-held entity, he was actively involved in the [corporation's] litigation, and the same counsel represented [the corporation] as now represents [stockholder plaintiff]").

[55] Defendants argue that because a derivative lawsuit is essentially two lawsuits in one – the first a suit to compel the corporation to sue and the second a suit on the corporation's behalf asserted by the stockholder, the Direct Action bars Plaintiff from bringing the first of these two lawsuits. Ans. Br. at 41-42. But the fundamentally procedural lawsuit to establish whether a corporation should be compelled to sue does not assert the *same claim* that was asserted in the Direct Action. Thus, *res judicata* does not apply. *TravelCenters of Am. LLC v. Brog*, 2008 WL 5101619, at *2 (Del. Ch. Nov. 21, 2008) ("[P]laintiff would be barred by principles of res judicata from asserting the same claims in future proceedings.").

[56] 1997 WL 208962 (Del. Ch. Apr. 21, 1997).

is a suit brought in the name of TLC Beatrice itself and seeks the recovery of substantial amounts paid out by the company."[57] While this decision was rendered in the context of a motion to stay the derivative action pending the adjudication of the earlier-filed direct action, it relies on the same underlying premise: a direct action and a derivative action are fundamentally different actions even if prosecuted by the same individual acting in different capacities.

The cases that Defendants cite in support of their contention that the Derivative Action are inapposite. For example, in *Maldonado v. Flynn*,[58] this Court dismissed a stockholder derivative suit as barred by the doctrine of claim splitting based on the prior dismissal of another derivative action. Despite Defendants' representation to the contrary,[59] the district court noted in the first

[57] *Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 1995 WL 694397, at *2 (Del. Ch. Nov. 21, 1995); *cf. Balin v. Amerimar Realty Co.*, 1996 WL 684377, at *4 (Del. Ch. Nov. 15, 1996) (holding that a parallel direct litigation brought by plaintiff would not prevent him from representing derivative plaintiffs in a separate action where "a finding for [plaintiff] on his individual claims [would not] preclude a recovery by the corporation on the derivative claims.").

[58] 417 A.2d 378 (Del. Ch. 1980).

[59] Ans. Br. at 38 (describing prior action as "shareholder's direct claims").

sentence of its initial opinion: "This is a ***derivative action*** ... for alleged violations of various provisions of the Securities Exchange Act of 1934."[60]

Orloff v. Shulman[61] is also distinguishable. In *Orloff*, the Court of Chancery held that *res judicata* barred a stockholder from bringing a derivative action against corporate fiduciaries following the dismissal of an earlier-filed direct action brought by the plaintiff's mother. In deciding whether *res judicata* precluded the later-filed derivative action, the Court noted: "As a rule of black-letter law, suits brought by the same party in another capacity are not subject to claim preclusion."[62] However, in *Orloff*, the Court applied an *exception* to this general rule, because the corporation was closely held,[63] and the Orloff family were the company's only minority stockholders.[64] The Court found these facts to be critical: "[The corporation] is a closely held corporation which has long had only

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[60] *Maldonado v. Flynn*, 448 F. Supp. 1032, 1034 (S.D.N.Y. 1978) (emphasis added); *aff'd in part, rev 'd in part* 597 F.2d 789, 790 (2d Cir. 1979) ("In this ***stockholders' derivative suit*** on behalf of … a Delaware Corporation …") (emphasis added); *see also Maldonado v. Flynn*, 485 F. Supp. 274, 277 (S.D.N.Y. 1980) ("This is a ***stockholder's derivative suit*** on behalf of Zapata Corporation …") (emphasis added).

[61] 2005 WL 3272355 (Del. Ch. Nov. 23, 2005).

[62] *Id.* at *8 (citing *Carlton Invs.*, 1997 WL 208962).

[63] *Id.* at *8.

[64] *Id.*

one minority shareholder group. As such, the nexus of interest between the derivative action and the individual action is likely to especially close."[65] These factors are not present here, and there is no reason to deviate from the general rule that where suits are brought by the same party in different capacities, *res judicata* does not apply.

Moreover, as *Maldonado* recognizes, claims can be split if there is a "valid reason" for doing so.[66] Because Plaintiff could not have known when he brought his direct action in January 2016 that ETE would successfully terminate the Merger Agreement, he could not be expected to bring derivative claims that he properly thought would be extinguished by the merger.[67] The termination of the

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[65] *Id.* In addition, the Court noted that the prior-filed New York action had involved "extensive discovery" and had been litigated through to a judgment on the merits and an appeal.

[66] *See Maldonado*, 417 A.2d at 382 ("Since the claim asserted in the District Court, transactionally defined, is identical to the claim asserted in this Court, even though the substantive theory of recovery asserted by [plaintiff] in the two courts is different, the claim has been split and must be dismissed in this Court, *unless there was a valid reason for the splitting*") (emphasis added).

[67] *Cf. Ambase Corp. v. City Investing Co. Liquidating Trust*, 326 F.3d 63, 73 (2d Cir. 2003) ("if the pleadings framing the issues in the first action would have permitted the raising of the issue sought to be raised in the second action, and *if the facts were known, or could have been known to the plaintiff in the second action at the time of the first action, then the claims in the second action are precluded*"), quoted in *LaPoint v. AmerisourceBergen Corp.*, 970 A.2d 185, 193 (Del. 2009) (emphasis in *AmerisourceBergen*).

ETE Merger Agreement, however, changed the landscape and justified the subsequent filing of this derivative action.[68] In situations where, like here, a stockholder could assert direct and derivative claims – even though everyone expects that the derivative claims would be extinguished by operation of a merger, requiring a stockholder to include the derivative claims from the outset could cause a substantial waste of the parties' and the Court's time and resources. The parties and the Court would be burdened with dealing with claims that in the vast majority of situations are going to be extinguished upon consummation of a merger.

[68] Defendants contend that the Direct Action asserted a claim that could only have been brought derivatively and therefore the Direct Action and the Derivative Action should be considered identical, derivative actions. Ans. Br. at 40-42. But historically claims of entrenchment were found to be direct. *In re Gaylord Container Corp. S'holders Litig.*, 747 A.2d 71, 83 (Del. Ch. 1999) ("In a case where the plaintiffs attack a combination of board actions as operating in tandem to injure the stockholders, 'the focus properly rests on the cumulative impact of [the actions] on the minority' in determining if the claims are individual or derivative.") (quoting *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 331 (Del. 1993)); *Carmody v. Toll Brothers, Inc.*, 723 A.2d 1180, 1188-89 (Del. Ch. 1998) ("An entrenchment claim ... [is] ... individual ... when the shareholder alleges that the entrenching activity directly impairs some right she possesses as a shareholder."). Thus, at least prior to *El Paso Pipeline GP Co. v. Brinckerhoff*, 152 A.3d 1248 (Del. 2016), there was a basis for asserting entrenchment claims directly on behalf of a class of Williams's stockholders. After this Court in *El Paso* narrowed the scope of dual-natured actions that can be prosecuted directly or derivatively, Plaintiff dismissed the Direct Action as no longer viable. This is not the equivalent of having filed successive derivative actions, as Defendants suggest.

Respectfully submitted,

DATED: September 11, 2017

/s/ Michael J. Barry

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