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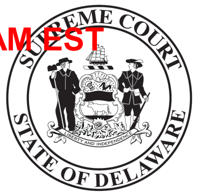

IN THE SUPREME COURT OF THE STATE OF DELAWARE

ARKANSAS TEACHER RETIREMENT SYSTEM, et al., Plaintiffs Below-Appellants, v. COUNTRYWIDE FINANCIAL CORPORATION, et al., Defendants Below-Appellees.	No. 14,2013 Certification of a Question of Law From the United States Court of Appeals for the Ninth Circuit No. 10-56340 D.C. No. 2:07-cv-06923-MRP-MAN

PLAINTIFFS-APPELLANTS' CORRECTED OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

NATURE OF PROCEEDINGS 1

SUMMARY OF THE ARGUMENT 2

STATEMENT OF FACTS 5

A. PLAINTIFFS FILE THE FEDERAL DERIVATIVE COMPLAINT 5

B. THE FEDERAL DISTRICT COURT LARGELY SUSTAINS THE DERIVATIVE CLAIMS, INCLUDING CLAIMS FOR THE FRAUD AND BREACHES OF FIDUCIARY DUTY THAT NECESSITATED THE MERGER 7

C. COUNTRYWIDE DIRECTORS NEGOTIATE THE FIRE SALE MERGER WITH BANK OF AMERICA 10

D. THE DISTRICT COURT GRANTS JUDGMENT ON THE PLEADINGS TO DEFENDANTS 10

E. THE DELAWARE DEAL CASE 10

F. THE DISTRICT COURT DENIES RECONSIDERATION, AND PLAINTIFFS APPEAL TO THE NINTH CIRCUIT 13

ARGUMENT 14

A. IN *ARKANSAS TEACHERS*, THIS COURT CONCLUDED THAT THE FACTS OF THE COUNTRYWIDE MERGER SATISFIED THE REQUIREMENTS FOR POST-MERGER DERIVATIVE STANDING 14

B. OTHER COURTS AGREE THAT THE FACTS OF THE COUNTRYWIDE MERGER SATISFY THE FRAUD EXCEPTION 19

C. THE *VILLARI* COURT MISINTERPRETED *ARKANSAS TEACHERS* 20

D. EVEN AFTER *ARKANSAS TEACHERS*, THE FRAUD EXCEPTION REMAINS NARROW 25

E. PUBLIC POLICY REQUIRES THAT PLAINTIFFS BE PERMITTED TO CONTINUE TO PURSUE THEIR DERIVATIVE CLAIMS 27

1. The Economic Injury Resides With Countrywide's Former Shareholders 28

2. Depriving Countrywide's Former Shareholders of the Ability To Prosecute The Derivative Claims Would Allow Defendants To Escape Liability Entirely 31

3. Depriving Plaintiff of Post-Merger Standing Here Would Create Perverse Incentives For Corporate Fiduciaries..... 32

CONCLUSION.. 34

TABLE OF AUTHORITIES

Page(s)

CASES

Arkansas Teacher Ret. Sys. v. Caiafa,
996 A.2d 321 (Del. 2010) .... passim

Arnett v. Gerber Scientific, Inc.,
566 F. Supp. 1270 (S.D.N.Y. 1983) 16

Atlantis Plastics Corp. v. Sammons,
1988 WL 32371 (Del. Ch. Mar. 30, 1988) 30

Bangor Punta Operations, Inc. v. Bangor & Aroostock R.R. Co.,
417 U.S. 703 (1974) 23

In re Bear Stearns Cos., Sec., Derivative, & ERISA Litig.,
2011 WL 4063685 (S.D.N.Y. Sept. 13, 2011) 20

Bokat v. Getty Oil Co.,
262 A.2d 246 (Del. 1970) 15, 17, 24

Braasch v. Goldschmidt,
199 A.2d 760 (Del. Ch. 1964) 24

In re Countrywide Corp. S'holders Litig.,
2009 WL 846019 (Del. Ch. Mar. 31, 2009) ("*Countrywide II*") ... passim

In re Countrywide Corp. S'holders Litig.,
2009 WL 2595739 (Del. Ch. Aug. 24, 2009) ("*Countrywide III*") 27

In re Countrywide Fin. Corp. Derivative Litig.,
542 F. Supp. 2d 1160 (C.D. Cal. 2008) ("*Countrywide I*") 5

In re Countrywide Fin. Corp. Derivative Litig.,
554 F. Supp. 2d 1044, 1057, 1083 (C.D. Ca. 2008) ("*Countrywide IV*") 7, 8, 9

Courtland Manor, Inc. v. Leeds,
347 A.2d 144 (Del. Ch. 1976) 29, 30

Evmar Oil Corp. v. Getty Oil Co.,
1978 WL 1067 (C.D. Cal. Mar. 17, 1978) 15

Feldman v. Cutaia,
951 A.2d 727 (Del. 2008) 15, 24, 25

Gentile v. Rossette,
906 A.2d 91 (Del. 2006) 25

Grosset v. Wenaas,
42 Cal. 4th 1100 (Ca. 2008) 23

Hamilton Partners, L.P. v. Englard,
11 A.3d 1180, 1206 (Del. Ch. 2010) 33

In re J.P. Morgan Chase & Co. S'holder Litig.,
906 A.2d 766 (Del. 2006) 25

Keyser v. Commonwealth Nat'l Fin. Corp.,
120 F.R.D. 489 (M.D. Pa. 1988) 23

Kramer v. W. Pac. Indus., Inc.,
546 A.2d 348 (Del. 1988) 12, 15, 24

Lambrecht v. O'Neal,
3 A.3d 277, 281 (Del. 2010) 14, 22

Lewis v. Anderson,
477 A.2d 1040 (Del. 1984) .... passim

Lewis v. Ward,
852 A.2d 896 (Del. 2004) 15

In re Massey Energy Co. Derivative & Class Action Litig.,
2011 WL 2176479 (Del. Ch. May 31, 2011) 19, 20, 25

In re Mercury Interactive Corp. Derivative Litig.,
487 F. Supp. 2d 1132 (N.D. Cal. 2007) 23

Midland Food Services, LLC v. Castle Hill Holdings V, LLC,
792 A.2d 920 (Del.Ch. 1999) 29

Miller v. Steinbach,
268 F. Supp. 255 (S.D.N.Y. 1967) 23

Perlman v. Feldmann,
219 F.2d 173 (2d Cir. 1955) 23

Schlick v. Castle,
1974 WL 467 (S.D.N.Y. Dec. 4, 1974) 15, 23

Schoon v. Smith,
953 A.2d 196 (Del. 2008) 32

Villari v. Mozilo,
208 Cal. App. 4th 1470 (Cal. Ct. App. 2012) .... passim

NATURE OF PROCEEDINGS

On January 10, 2013, the Ninth Circuit issued an Order certifying to this Court the following question:

> Whether, under the "fraud exception" to Delaware's continuous ownership rule, shareholder plaintiffs may maintain a derivative suit after a merger that divests them of their ownership interest in the corporation on whose behalf they sue by alleging that the merger at issue was necessitated by, and is inseparable from, the alleged fraud that is the subject of their derivative claims.

This Court accepted the certification on January 14, 2013, finding that the record reflects that the material facts are not in dispute. This Court further found that the legal question presented involves a dispositive question of Delaware law, the answer to which was not clear to the Ninth Circuit panel from controlling precedent in Delaware judicial decisions. And, finally, this Court found that there are important and urgent reasons for an immediate determination of the question certified. *See* Exhibits A and B.

SUMMARY OF THE ARGUMENT

In its unanimous *en banc* opinion in *Arkansas Teacher Ret. Sys. v. Caiafa,* 996 A.2d 321 (Del. 2010) ("*Arkansas Teachers")*, this Court went to great lengths to clarify Delaware law on post-merger derivative standing, even though the issue was not squarely before it. This Court instructed that Delaware law does not allow officers and directors of a publicly traded company, through violations of their fiduciary duties and fraudulent conduct, to cause the near collapse of a company, and then escape liability for shareholder derivative claims through a necessary fire sale merger. *See id.* at 323. Given the record before it, and recognizing that the allegations in the federal shareholder derivative action against Countrywide's former officers and directors involve, at a minimum, a "snowballing pattern of fraudulent conduct and conscious neglect" that "bankrupted a multibillion-dollar company," "made the company's dissolution or auction a fait accompli," and "necessitated a fire sale merger," *id.* at 323-324, this Court took the unusual step of *sua sponte* deciding the appeal *en banc*, and clarifying its prior jurisprudence under *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), in which this Court established two exceptions to the "continuous ownership requirement" for a plaintiff to maintain derivative standing post-merger.

Whereas courts following *Anderson* had interpreted a "strict" rule against continuing derivative standing post-merger with only two "narrow exceptions," this unanimous *en banc* Court expressly clarified in *Arkansas Teacher* that one of those exceptions, the "fraud exception," is not strictly limited to where the merger itself is the

subject of a claim of fraud, but rather "its terms apply more broadly to fraud connected to the merger." *Arkansas Teachers*, 996 A.2d at 323. In applying the "fraud exception" to the specific conduct alleged against the Countrywide officers and directors that precipitated its merger with Bank of America ("BofA") ("the Merger"), this Court further explained that such "fraud connected to the merger" includes "fraudulent conduct that necessitated that merger." *Id.*

This Court recognized, however, that it did not have before it the "proper vehicle" to dispositively adjudicate whether Plaintiffs maintained derivative standing in the federal derivative action. *Id.* at 323. Thus, while recognizing that the application of the *Anderson* "fraud exception" to derivative standing was not before it as this Court adjudicated objections to a proposed deal case settlement, this Court took great care to clarify the fraud exception.

Plaintiffs understand that this Court does not write without purpose. If this Court intended merely to affirm the Chancery Court's approval of the deal case settlement, it need only have written the first two paragraphs of the opinion. The fact that it purposefully reached out, *en banc*, to take on this issue, sent a strong message.

Despite this Court's directive in *Arkansas Teachers*, the district court presiding over the federal derivative action, the United States District Court for the Central District of California ("District Court"), interpreted this Court's decision in *Arkansas Teachers* as doing nothing more than reiterating prior interpretations of Delaware law, and holding that Plaintiffs satisfied no exception to the loss of post-merger derivative standing. Plaintiffs believe that the District

Court was incorrect in its interpretation of this Court's decision. Thus, Plaintiffs appealed the decision to the Ninth Circuit Court of Appeals ("Ninth Circuit").

The Ninth Circuit has since certified the question back to this Court. Now that the question has been expressly certified to it, this Court has before it the "proper vehicle" to dispositively decide the issue. Specifically, Plaintiffs ask this Court to respond to the Ninth Circuit that this Court meant what it said in *Arkansas Teacher* – that under the "fraud exception," shareholder plaintiffs may maintain a derivative suit after a merger that divests them of their ownership interest in the corporation on whose behalf they sue by alleging that the merger at issue was necessitated by, and is inseparable from, the alleged fraud that is the subject of their derivative claims.

STATEMENT OF FACTS

A. PLAINTIFFS FILE THE FEDERAL DERIVATIVE COMPLAINT

Beginning in October 2007, shareholders filed derivative complaints on behalf of Countrywide Financial Corporation ("Countrywide" or the "Company") against certain Countrywide officers and directors for their pervasive fraudulent conduct which drove Countrywide to the brink of bankruptcy at the expense of Countrywide shareholders. The consolidated complaint (the "Complaint") (Plaintiffs' Opening Appendix ("App."), A000001-232) describes in detail how, between 2004 and 2008, the Defendants completely abandoned their fiduciary duties owed to Countrywide to the detriment of its shareholders. The Complaint alleges state law derivative claims against Defendants for: breach of fiduciary duty and aiding and abetting breaches of fiduciary duties (Counts I and V), gross mismanagement (Count II), corporate waste (Count III), and insider trading (Count IV); and federal law derivative claims for securities fraud violations (Counts VI and VII), insider trading (Count VIII), and issuing a false proxy statement (Count IX), 15 U.S.C. §§ 10(b), 20(a), 20A, 14(a).[1]

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[1] App. A000191-202. The Complaint also asserts several class action claims against Defendants and against BofA for breaches of duty in connection with the proposed Merger (Counts X through XI). App. A000202-204. The District Court stayed the direct claims in deference to a later-filed action in Chancery Court seeking to enjoin the Merger, as discussed below. *See In re Countrywide Fin. Corp. Derivative Litig.*, 542 F. Supp. 2d 1160, 1174 (C.D. Cal. 2008) ("*Countrywide I*"). The release in the settlement in the deal case before the Chancery Court included the direct claims, but expressly carved out the derivative claims in the instant District Court action.

As detailed in the Complaint, and summarized in the Order of the District Court largely sustaining the derivative claims, Defendants caused Countrywide to dramatically shift its strategic direction away from traditional fixed-rate home loans to borrowers with "prime" credit scores, in favor of a wide range of "non-traditional" high-risk loans designed to allow people to borrow more money than would be available under traditional lending guidelines. *See* Complaint ¶¶108-131(App. A000045-55). Due to the Defendants' conscious misconduct and abdication of their fiduciary duties, Countrywide's shift to selling riskier products devolved into a reckless foray into predatory lending practices and a failure to protect Countrywide from the increased risks it was facing. All of this occurred while Defendants were reaping hundreds of millions in illegal insider selling while simultaneously causing Countrywide to purchase its stock at inflated prices through a multi-billion dollar buyback program. *See id.* ¶¶321-342 (App. A000128-139).

As detailed in the Complaint, the Defendants' fraudulent conduct and breaches of fiduciary duty resulted in drastic stock price drops (from $45 in February 2007, to less than $5 in January 2008), numerous federal and state government investigations into lending practices and accounting, significant liquidity constraints that limited Countrywide's ability to conduct business, and severe damage to Countrywide's goodwill and reputation. *See id.* ¶¶3, 231 (App. A000010-11; A000089). The Company's collapse was so swift, it

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In re Countrywide Corp. S'holders Litig., 2009 WL 846019, at *6 (Del. Ch. Mar. 31, 2009) ("*Countrywide II*").

prompted comparisons to some of the worst corporate scandals of the past decade, and prompted *The New York Times* to pose the query: "Is Countrywide 'Enron's Second Coming'?" *See* Complaint ¶¶2,259 (App. A000010; A000097-98).

The Complaint further details how, after looting the Company for their own personal gain, pushing it to the brink of bankruptcy, and standing by as the Company's stock price collapsed due to the revelation of the Company's accounting and lending practices, Defendants then agreed to a fire sale of the Company to BofA. *See* Complaint ¶¶343-367 (App. A000140-146).

B. THE FEDERAL DISTRICT COURT LARGELY SUSTAINS THE DERIVATIVE CLAIMS, INCLUDING CLAIMS FOR THE FRAUD AND BREACHES OF FIDUCIARY DUTY THAT NECESSITATED THE MERGER

By Order dated May 14, 2008, the District Court substantially denied Defendants' motions to dismiss the derivative claims, sustaining the claims under heightened pleading standards. *In re Countrywide Financial Corp. Derivative Litig.,* 554 F. Supp. 2d 1044, 1057, 1083 (C.D. Ca. 2008) ("*Countrywide IV")*.

In a 54-page opinion, the District Court concluded that the "allegations create a cogent and compelling inference that the [Countrywide officers and directors] misled the public with regard to the rigor of Countrywide's loan origination process, the quality of its loans, and the Company's financial situation – even as they realized that Countrywide had virtually abandoned its own loan underwriting practices." *Id.* at 1057. In addition, the District Court found that the fourteen confidential witnesses "paint a compelling portrait of a dramatic loosening of underwriting standards

in Countrywide branch offices across the United States," representing "a rampant disregard for underwriting standards." *Id.* at 1058-59. The District Court thus concluded that the confidential witnesses support a "strong inference of a Company-wide culture that, at every level, emphasized increased loan origination volume in derogation of underwriting standards." *Id.* at 1058.

The District Court rejected Defendants' arguments that the widespread malfeasance at Countrywide went on without the directors' knowledge: "[T]he idea that a Company-wide culture that encouraged unchecked deviations from underwriting standards in a way which would fatally affect the Company's continued financial performance went unnoticed by a Board of Directors simply does not square with the specific and comprehensive monitoring duties assigned to the members of the Board." *Id.* at 1065.

The Court also rejected defendants' attempt to blame Countrywide's downfall on a general "economic downturn," explaining that, "[i]ndependent of any turmoil in the capital markets, the widespread violations of underwriting standards, as alleged, would significantly raise the risk of loan default. When combined with what Plaintiffs allege are misrepresentations concerning the quality of Countrywide's loans, these underwriting issues would ultimately undermine confidence in the secondary market for Countrywide products." *Id.* at 1065-66.

The District Court also found that the massive insider sales allegations were consistent with the strong inference of scienter. The Court queried: "How could the Board members approve a repurchase

of $2.4 billion worth of stock, and nearly contemporaneously liquidate $148 million of their personal holdings just months before the stock dropped some 80-90%?" *Id.* at 1066-67.

The District Court likewise sustained the Complaint's corporate waste allegations with respect to the stock repurchase program, finding that the claim is "not subject to protection by the business judgment rule because, as the Court observed, it may have served to delay the eventual impairment caused by unsound business practices." *Id.* at 1078; *see also id.* at 1082-83.

Finally, the District Court found that "the Complaint pleads evidence of a 'sustained or systematic failure of the board to exercise oversight' . . . so as to create a substantial likelihood of liability for at least the members of those [Audit, Finance, and Ethics] Committees." *Countrywide IV*, 554 F. Supp. 2d at 1082 (quoting *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996)). The District Court concluded as follows:

> It defies reason, given the entirety of the allegations, that these Committee members could be blind to widespread deviations from the underwriting policies and standards being committed by employees at all levels. At the same time, it does not appear that the Committees took corrective action. . . . [The Complaint] provides enough of a factual basis for this Court to determine that a majority of the directors are "interested" for demand purposes . . . .[2]

[2] *Id.* at 1082. The District Court dismissed Count IV, the insider trading claim pursuant to California state law, claims brought against Defendants Dougherty and Snyder, and claims regarding Mozilo's compensation.

C. COUNTRYWIDE DIRECTORS NEGOTIATE THE FIRE SALE MERGER WITH BANK OF AMERICA

After the Defendants' fraudulent conduct and breaches of fiduciary duty decimated the former multibillion-dollar company, Defendants (and Countrywide shareholders) were faced with two alternatives: place the Company into bankruptcy, or negotiate a fire sale merger.

Ultimately, Defendants sold Countrywide to Bank of America in an all-stock transaction equal to a mere $4.33 per share in Bank of America stock –**less than 10% of Countrywide's $45 share price just a year earlier in February 2007.**

D. THE DISTRICT COURT GRANTS JUDGMENT ON THE PLEADINGS TO DEFENDANTS

Following the Merger, by Order dated December 11, 2008, the District Court granted judgment on the pleadings to Defendants as to Plaintiffs' shareholder derivative claims. Ex. E. The sole basis for the Court's ruling was that Plaintiffs lost standing to pursue the derivative claims upon consummation of Countrywide's Merger with BofA. The District Court, citing this Court's seminal decision in *Lewis*, interpreted Delaware law as containing only two narrow exceptions to the "continuous ownership requirement," and found that Plaintiffs did not meet either exception and thus no longer maintained derivative standing following the Merger. Ex. E at 5.

E. THE DELAWARE DEAL CASE

While the federal derivative case was proceeding, and immediately after the announcement on January 11, 2008 of the proposed Merger, three individual Countrywide shareholders filed complaints alleging direct claims seeking to enjoin the Merger. *See In re Countrywide*

Corp. S'holders Litig. (the "Delaware Action" or "deal case"), C.A. No. 3464-VCN (Del. Ch.). The Delaware plaintiffs alleged that Countrywide's directors breached fiduciary duties owed directly to shareholders by agreeing to inappropriate merger terms and soliciting shareholder approval based on false and misleading proxy materials.

In May 2008, the parties in the Delaware Action reached a proposed settlement. Through the settlement, the Delaware plaintiffs agreed to settle and release all claims related to the Merger in exchange for disclosures regarding the negotiation of the transaction. The settlement expressly carved out (*i.e.,* did not release) the derivative claims in Counts I through IX of the Complaint in the District Court. *See, Countrywide II*, 2009 WL 846019, at *6.

Plaintiffs herein, in their capacities as class members in the Delaware Action, filed objections to the proposed settlement of the Delaware Action on the grounds that it provided no monetary recovery for the release of class damages claims related to the Countrywide directors' breaches of fiduciary duty in connection with their negotiation of the Merger and provided no right to opt out of the class. *Countrywide II*, 2009 WL 846019, at *4.

The Chancery Court overruled Plaintiffs' objections. *Countrywide II*, 2009 WL 846019. Plaintiffs appealed to this Court, and on March 12, 2010, this Court issued an Order stating, *sua sponte*, that the appeal would be decided *en banc* pursuant to Delaware Supreme Court Rule 4(d). This unusual procedure is reserved for situations where either the panel cannot reach a unanimous decision, or where "there is

a reasonable likelihood that a prior decision of the Court may be modified or overruled."

On May 21, 2010, this Court issued its *en banc* unanimous opinion written by Chief Justice Steele in *Arkansas Teachers*. This Court affirmed the Chancery Court's approval of the deal case settlement, holding that "the Vice Chancellor did not abuse his discretion in approving the settlement, despite facts in the complaint suggesting that the Countrywide directors' premerger agreement fraud severely depressed the company's value at the time of BofA's acquisition, and arguably necessitated a fire sale merger." 996 A.2d at 324.

In addition, while observing that the issue was not directly before it (but rather before the federal District Court), this Court seized the opportunity to revisit the scope of the "fraud exception" to loss of standing following a merger. *Id.* at 322. The "fraud exception" has been described as the principle that shareholders may continue to prosecute derivative claims after a merger that results in the loss of their shares "if the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive shareholders of the standing to bring a derivative action." *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348, 354 (Del. 1988). Examining the specific conduct alleged against Mozilo and the other Countrywide officers and directors, this Court observed that "[t]he extent of the Countrywide directors' allegedly fraudulent conduct ... would have necessitated (a) corporate rescue; and, (b) individual legal protection. A merger was one of few available alternatives that meet both of those objectives after the board's allegedly fraudulent schemes bankrupted a

multibillion-dollar company. *Delaware law recognizes a single, inseparable fraud when directors cover massive wrongdoing with an otherwise permissible merger.* ... An otherwise pristine merger cannot absolve fiduciaries from accountability for fraudulent conduct that necessitated that merger." 996 A.2d at 323. (emphasis added). The Court also directed that if the pre-merger fraudulent conduct that necessitated the merger was successfully pleaded, then the former Countrywide shareholders, rather than Countrywide, could recover from the former Countrywide directors. "In that case, the injured parties would be the shareholders who would have post-merger standing to recover damages instead of the corporation." *Id.* at 324.

F. THE DISTRICT COURT DENIES RECONSIDERATION, AND PLAINTIFFS APPEAL TO THE NINTH CIRCUIT

Following this Court's *Arkansas Teachers* decision, Plaintiffs filed a motion for reconsideration of the District Court's judgment on the pleadings, arguing that Plaintiffs satisfied the "fraud exception" for post-merger derivative standing as clarified in *Arkansas Teachers*. The District Court denied the motion, and Plaintiffs appealed to the Ninth Circuit. Ex. D.

On January 10, 2013 the Ninth Circuit issued an Order certifying to this Court the question whether the "fraud exception" applies when plaintiffs allege that the merger that divested plaintiffs of their shares was necessitated by, and was inseparable from, the underlying fraud that formed the basis for the derivative claims. Ex. A. This Court accepted the certification on January 14, 2013. Ex. B.

ARGUMENT

Question Presented

Whether, under the "fraud exception" to Delaware's continuous ownership rule, shareholder plaintiffs may maintain a derivative suit after a merger that divests them of their ownership interest in the corporation on whose behalf they sue by alleging that the merger at issue was necessitated by, and is inseparable from, the alleged fraud that is the subject of their derivative claims.

Scope of Review

The question presented in this matter is a question of law certified to this Court by the United States Court of Appeals for the Ninth Circuit, and it is subject to *de novo* review. *See Lambrecht v. O'Neal*, 3 A.3d 277, 281 (Del. 2010) (certified question concerning standing requirements to bring a derivative action presents an issue of law that is reviewed de novo).

Merits of Argument

A. IN *ARKANSAS TEACHERS*, THIS COURT CONCLUDED THAT THE FACTS OF THE COUNTRYWIDE MERGER SATISFIED THE REQUIREMENTS FOR POST-MERGER DERIVATIVE STANDING

To bring and maintain a derivative action, Delaware requires that the plaintiff have been a stockholder at the time of the complained-of transaction, and that the plaintiff remain a stockholder throughout the duration of the suit. *See Anderson*, 477 A.2d at 1046. Ordinarily, under this rule, when the plaintiff loses his stock in a merger during the course of a lawsuit, he loses standing to maintain the action and the suit is terminated. *See id.* at 1047. However, in *Anderson*, this Court identified two exceptions to the loss-of-standing

rule: "(1) where the merger itself is the subject of a claim of fraud; and (2) where the merger is in reality a reorganization which does not affect plaintiff's ownership of the business enterprise." 477 A.2d at 1047 n.10. In support of its exception for situations where "the merger itself is the subject of a claim of fraud," *Anderson* cited *Bokat v. Getty Oil Co.*, 262 A.2d 246, 249 (Del. 1970). The relevant portion of *Bokat*, in turn, stated that "[i]f a proposed merger is sought to be used for the coverup of wrongful acts of management," a court of equity would protect the rights of the "innocent shareholder," *id.* at 249. In subsequent decisions, this Court described the fraud exception in somewhat different terms, permitting continued standing when the "fraud" consisted of the merger itself being entered into for the sole purpose of eliminating derivative claims. See *Kramer*, 546 A.2d at 354; *Lewis v. Ward*, 852 A.2d 896, 902 (Del. 2004). However, this Court has continued to cite *Bokat*, with its formulation that standing continues after mergers "used for the coverup of wrongful acts of management," in cases discussing the *Anderson* exceptions. *See, e.g.*, *Kramer*, 546 A.2d at 354; *Feldman v. Cutaia*, 951 A.2d 727, 731 n.20 (Del. 2008).[3]

[3] After *Bokat*, courts in other jurisdictions routinely held that the derivative action, as a tool of equity, responds to equitable concerns, including the unfairness of permitting directors to escape liability for fraudulent acts via a merger that itself functions as a continuation of the fraud. *See, e.g.*, *Evmar Oil Corp. v. Getty Oil Co.*, 1978 WL 1067, at *12 (C.D. Cal. Mar. 17, 1978) ("where the specific fraudulent acts of which plaintiffs complain led to the merger, courts have been hesitant to allow the merger to preclude the derivative suit"); *Schlick v. Castle*, 1974 WL 467, at *3 (S.D.N.Y. Dec. 4, 1974) ("It seems incongruous and inequitable that former directors and the surviving corporation should be immune from suit for fraud in a merger because the merged corporation in technical terms no

In *Arkansas Teachers*, this Court examined the fraud exception in the specific context of the Countrywide/Bank of America Merger, and concluded that the Complaint alleged facts that, if true, satisfied the requirements for the exception.

The Court began by briefly affirming the Chancery Court's approval of the deal case settlement. *See Arkansas* Teachers, 996 A.2d at 322. The Court was able to affirm approval of the settlement because, as described above, the settlement carved out (*i.e.*, did not release) the derivative claims, and even if the derivative claims were to be extinguished by the Merger (as the Chancery Court had concluded they would be), this fact would not affect the fairness of the settlement of the deal case claims at issue in that settlement. *See id.*

Immediately after its two paragraphs affirming the Chancery Court's decision, however, this Court launched into a discussion of post-merger derivative standing under Delaware law. The opinion began by restating the general rule, citing *Ward* and *Anderson*, that "[o]ther than in instances of fraud or reorganization, a plaintiff loses standing to maintain a derivative suit where the corporation, in which the plaintiff holds stock, merges with another company." *Id.* at 322-23. The Court reiterated its previous holdings that stockholders

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longer exists, when the fraud under attack was the very means by which the merged corporation's existence was ended." (collecting cases)); *see also Arnett v. Gerber Scientific, Inc.*, 566 F. Supp. 1270, 1273-74 (S.D.N.Y. 1983) (derivative standing will survive post-merger if "(1) plaintiffs' disposition of the stock was involuntary; (2) the disposition was related to the allegedly illegal acts of defendants; and (3) the remedy sought would result in plaintiffs regaining shareholder status"; distinguishes cases where standing was lost because the merger was unrelated to the wrongdoing alleged).

would retain post-merger derivative standing "if the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive stockholders of the standing to bring a derivative action." *Id.* at 323 (quoting *Ward*, 852 A.2d at 902).

The Court then explained that though Plaintiffs had not shown that the Merger here was conducted *solely* to deprive them of standing, the misconduct of Countrywide's directors "necessitated (a) corporate rescue; and, (b) individual legal protection. A merger was one of few available alternatives that met both of those objectives after the board's allegedly fraudulent schemes bankrupted a multibillion-dollar company." *Id.* at 323. Under such circumstances, attempting to disentangle the directors' motives is unnecessary: "Delaware law recognizes a single, inseparable fraud when directors cover massive wrongdoing with an otherwise permissible merger." *Id.* This formulation is consistent with both the exception as described in *Anderson* – i.e., where "the merger itself is the subject of a claim of fraud," 477 A.2d at 1047 n.10, and the original formulation from *Bokat*. *See* 262 A.2d at 249 (recognizing that courts would protect innocent shareholders "[i]f a proposed merger is sought to be used for the coverup of wrongful acts of management").

The Court went on to note that the Vice Chancellor had viewed the situation too narrowly. The Vice Chancellor had concluded that the fraud exception to the loss of post-merger standing did not apply because "avoiding derivative liability was neither the only nor the principal reason for supporting the transaction." *Arkansas Teachers*, 996 A.2d at 323 (quoting *In re Countrywide*, 2009 WL 2595739, at *17).

This Court responded, "Although we agree that the Countrywide directors and stockholders ran from the *crest* of a ruinous wave of losses, we cannot ignore the close connection between that wave's crest and its underlying trough. ... An otherwise pristine merger cannot absolve fiduciaries from accountability for fraudulent conduct that necessitated that merger." *Id.* In other words, this Court rejected the Vice Chancellor's overly-technical reading of the fraud exception, and affirmed that – consistent with *Bokat* and *Anderson* – where the fraud and the merger represent a single, indivisible set of circumstances, the fraud exception applies. Applying this standard, this Court found that such facts were alleged in this case: "TRS has pleaded facts supporting a colorable claim of fraud that, if proved, would have made the company's dissolution or auction a *fait accompli*." *Id.* As this Court concluded, "[A]fter allegedly intentionally engaging in fraudulent conduct that caused the stock price to plummet near bankruptcy, Countrywide directors would understandably seek an acquirer to effect a merger that would extinguish potential derivative claims during such a period of upheaval that they would have few alternatives. *Whether this plausible scenario reflects this board's single, cohesive plan or merely ties together, like patchwork, a snowballing pattern of fraudulent conduct and conscious neglect, the result is the same . . . .*" *Id.* (emphasis added).

In other words, this Court concluded that when a single fraudulent scheme has both the necessary and predictable object of *forcing* a merger that will both "cover up the wrongful acts of management" while simultaneously providing legal protection to the

faithless directors, there is no need to engage in an angels-on-pinheads inquiry as to the directors' "primary" motive. Rather, "Delaware law recognizes a single, inseparable fraud." *Id.*

Because the procedural posture of *Arkansas Teachers* was an objection to a settlement of the Merger Claims, TRS had not presented the derivative claims to the Vice Chancellor, and therefore did not present this Court "with the proper vehicle to consider whether TRS meets the fraud exception to maintain a post-merger claim." *Id.* at 323. The Court did note, however, that "[i]f the Vice Chancellor had found that TRS had successfully pleaded its fraud claim, TRS - rather than Countrywide - could recover from the former Countrywide directors." *Id.* at 323-24.

This certified question, now, does present the "proper vehicle to consider whether TRS meets the fraud exception to maintain a post-merger claim." According to this Court's analysis in *Arkansas Teachers*, Plaintiffs' allegations that Defendants engaged in a fraudulent scheme that predictably and necessarily ended with the collapse of the company – and a merger that Countrywide shareholders had no choice but to approve – is sufficient, at the pleading stage, to fall within the fraud exception to the loss of post-merger standing.

B. OTHER COURTS AGREE THAT THE FACTS OF THE COUNTRYWIDE MERGER SATISFY THE FRAUD EXCEPTION

Since *Arkansas Teachers* was decided, other courts have agreed that, under the facts presented here, the fraud exception to post-merger standing is satisfied. For example, in *In re Massey Energy Co. Derivative & Class Action Litig.*, 2011 WL 2176479 (Del. Ch. May 31,

2011), Chancellor Strine summarized *Arkansas Teachers* as finding that "a board may not immunize itself from liability by ruining a corporation's value, and then selling the wreckage to a third-party who is acting in good faith. The Supreme Court [in *Arkansas Teachers*] appears to have perceived that there was a factual basis for the fraud exception in *Lewis* to apply but that the objector had failed to invoke that exception in a fair and timely manner." *Id.* at *30. The Chancellor went on to conclude that in *Arkansas Teachers*, this Court found that the fraud exception was "satisfied" because it "treated the sale of Countrywide as being inseparable from the Countrywide directors' pre-merger fraudulent conduct." *Id.* As Chancellor Strine concluded, "[T]he Supreme Court made plain that 'an otherwise pristine merger cannot absolve fiduciaries from accountability for fraudulent conduct that necessitated the merger.'" *Id.* (quoting *Arkansas Teachers*, 996 A.2d at 323).

Similarly, the court in *In re Bear Stearns Cos., Sec., Derivative, & ERISA Litig.*, 2011 WL 4063685 (S.D.N.Y. Sept. 13, 2011), following *Massey*, interpreted *Arkansas Teachers* to hold that "under the facts alleged, the merger was a piece, albeit a relatively clean one, of the larger fraud which destroyed Countrywide, bringing it within the fraud exception." *Id.* at *3.

C. THE *VILLARI* COURT MISINTERPRETED *ARKANSAS TEACHERS*

Parallel to Plaintiffs' federal action, certain Countrywide stockholders filed a California state court derivative action arising out of the Countrywide fraud. After the claims were dismissed for lack of standing following the Merger, a plaintiff appealed to

California's intermediate appellate court for the Second District. *See Villari v. Mozilo*, 208 Cal. App. 4th 1470 (Cal. Ct. App. 2012). In affirming the dismissal, rather than recognize this Court's explicit finding that the Countrywide merger involved a "single, inseparable fraud," the intermediate appellate court focused only on the first two paragraphs of this Court's *Arkansas Teachers* opinion, concluding that this Court "expressly stated that the completion of the Countrywide merger extinguished the objectors' derivative claim." *Id.* at 1484. The *Villari* court went on to conclude that the entire rest of the discussion in *Arkansas Teachers* concerned direct, rather than derivative, standing, and therefore could not be taken to mean that the Countrywide shareholders maintained post-merger derivative standing. *See id.* at 1484-85. It is clear that the California state court incorrectly interpreted this Court's decision.

To begin, the opening paragraphs on which *Villari* relied do not appear to represent this Court's conclusion that derivative standing had been extinguished, but merely recapped that Plaintiffs "objected [to the settlement] on the basis that the Vice Chancellor failed to value [Plaintiffs'] derivative claim pending in a companion Federal District Court action. The Vice Chancellor denied the objection and approved the settlement, allowing BOA to close its acquisition of Countrywide, thus extinguishing [Plaintiffs'] standing to pursue derivative claims." *Arkansas Teachers*, 996 A.2d at 322. Rather than representing a definitive ruling that derivative claims had been extinguished by the Merger, this appears to be merely a summary of the basis for Plaintiffs' objection to the class action settlement. *See*

Countrywide II, 2009 WL 846019, at *7. This Court merely noted that even if the derivative claims were extinguished, that fact would not affect the fairness of the settlement of the direct claims. Indeed, later in the *Arkansas Teachers* opinion, this Court explicitly stated that it had *not* been presented with a vehicle that would allow it to rule on whether the fraud exception was met, thus making it clear that it could *not* have held that derivative standing had been extinguished. *See* 996 A.2d at 323.[4]

Next, the *Villari* court reasoned that this Court's decision in *Lambrecht*, decided three months after *Arkansas Teachers*, reaffirmed the narrow scope of the fraud exception as interpreted by defendants. 208 Cal. App. 4th at 1484. However, *Lambrecht* merely recited the rule that standing will survive a merger "where the merger itself is the subject of a claim of fraud, being perpetrated merely to deprive shareholders of their standing to bring the derivative action." *Lambrecht*, 3 A.3d at 284 n.20. As explained above, *Arkansas Teachers* elaborated on this formulation to recognize that it *includes* situations where the plaintiffs plead a "fraud that, if proved, would have made the company's dissolution or auction a *fait accompli*." *Arkansas Teachers*, 996 A.2d at 323. The *Lambrecht* Court had no opportunity or reason to delve into the nuances of *Arkansas Teachers* because in *Lambrecht*, the plaintiffs did *not* seek to invoke the fraud exception. 3 A.3d at 284-85. Thus, *Lambrecht*'s simple recitation of the general standard – without examination of the particular types of

[4] The District Court in this action similarly focused solely on the first two paragraphs of the *Arkansas Teachers* decision when dismissing Plaintiffs' claims, providing no additional analysis. Ex. C.

fact-patterns encompassed by the rule – is not persuasive to defendants' argument that under the Countrywide facts, derivative standing was extinguished by the merger.

The *Villari* court then reasoned that since the plaintiff alleged that he was entitled to recover individually now that Countrywide no longer existed as a separate entity, it could only mean that the plaintiff sought a direct, rather than derivative, remedy. 208 Cal. App. 4th at 1484-85. However, *Arkansas Teachers* itself recognized that in circumstances where the merger has been completed and the fraud exception applies, derivative remedies may "pass through" to the individual plaintiff. *See* 996 A.2d at 324. This is hardly surprising; courts often permit individual recoveries even in derivative actions when a failure to do so would produce an inequitable result, or allow the wrongdoer to benefit from his misconduct.[5] Indeed, this Court must have intended such a result in *Anderson*, because *Anderson* discussed the issue of post-merger derivative standing in the context of both stock-for-stock and cash-out mergers. *See* 477 A.2d at 1042, 1047. If this Court had not intended that remedies would flow through to shareholders, the

[5] *See Bangor Punta Operations, Inc. v. Bangor & Aroostock R.R. Co.*, 417 U.S. 703, 718 n.18 (1974) ("Some courts have adopted the concept of a pro-rata recovery where there are innocent minority shareholders. Under this procedure, damages are distributed to the minority shareholders individually on a proportional basis, even though the action is brought in the name of the corporation to enforce primary rights."); *Perlman v. Feldmann*, 219 F.2d 173, 178 (2d Cir. 1955); *Grosset v. Wenaas*, 42 Cal. 4th 1100, 1119 (Ca. 2008) (citing cases); *In re Mercury Interactive Corp. Derivative Litig.*, 487 F. Supp. 2d 1132, 1137 (N.D. Cal. 2007); *Miller v. Steinbach*, 268 F. Supp. 255, 269 (S.D.N.Y. 1967); *Keyser v. Commonwealth Nat'l Fin. Corp.*, 120 F.R.D. 489, 493 (M.D. Pa. 1988); *Schlick*, 1974 WL 467, at *3 (collecting cases).

exception would be pointless for cash-out mergers, because it would yield no possible benefit to the plaintiffs.[6]

The *Villari* court also highlighted that *Arkansas Teachers* cited *Braasch v. Goldschmidt*, 199 A.2d 760 (Del. Ch. 1964), in support of its reasoning, pointing out that the *Braasch* discussion concerned direct, rather than derivative, claims. 208 Cal. App. 4th at 1485. In the *Villari* court's view, this indicated that the *Arkansas Teachers* discussion concerned only direct claims. But *Villari* overlooked that *Bokat* – the foundational case for the fraud exception – *also* was discussing *direct*, rather than derivative, claims. *See Bokat*, 262 A.2d at 249 ("If a proposed merger is sought to be used for the coverup of wrongful acts of management, a Court of Equity in an action making a direct attack on the merger can and will protect the innocent stockholder victim. . . . This plaintiff, however, took no direct action to restrain or to attack the merger of Tidewater into Getty Oil."). Despite this fact, *Bokat* has been repeatedly cited by this Court as justification for allowing post-merger *derivative* claims. *Anderson*, 477 A.2d at 1046 n.10; *Kramer*, 546 A.2d at 354; *Feldman*, 951 A.2d at 731 n.20. Therefore, the mere citation to *Braasch* in a

[6] In *Feldman*, this Court made clear that the nature of the action is *not* determined by whether the plaintiff expects damages to be awarded individually. As this Court put it, "Where all of a corporation's stockholders are harmed and would recover pro rata in proportion with their ownership of the corporation's stock solely because they are stockholders, *then the claim is derivative in nature*. The mere fact that the alleged harm is ultimately suffered by, or the recovery would ultimately inure to the benefit of, the stockholders does not make a claim direct under *Tooley*." 951 A.2d at 733. (emphasis added). Because any remedy in *Villari* would unquestionably be "pro rata in proportion with [the plaintiffs'] ownership of the corporation's stock solely because they are stockholders," the claim advanced in *Villari* (and in this case) was necessarily derivative.

similar fashion cannot be taken as evidence that this Court was discussing only direct claims. In fact, in *Massey*, Chancellor Strine interpreted the *Braasch* citation as *further evidence* that this Court in *Arkansas Teachers* had concluded that the facts of the Countrywide merger satisfied the fraud exception. *See Massey*, 2011 WL 2176479, at *30.

The *Villari* court's reading of *Arkansas Teachers* as a discussion of direct rather than derivative claims seems particularly tortured in light of the fact that *Arkansas Teachers* repeatedly refers to "derivative" claims, *see* 996 A.2d at 322-23, but *never* references "direct" claims; indeed, the word "direct" never appears in the opinion.[7] Moreover, under Delaware law, the existence of a merger affects the vitality only of derivative claims, not direct ones. *See Feldman*, 951 A.2d at 731. Thus, this Court's discussion makes no sense as an examination of direct claims: there was no need for the Court to discuss the conditions under which direct claims might proceed post-merger – or to discuss the possibility of corporate managers seeking a merger to protect them from direct liability, *Arkansas Teachers,* 996 A.2d at 323 – because direct claims may always proceed post-merger, and a merger never protects corporate managers from direct liability.

D. EVEN AFTER *ARKANSAS TEACHERS,* THE FRAUD EXCEPTION REMAINS NARROW

Plaintiffs do not interpret this Court's *en banc* decision in *Arkansas Teachers* to "adopt[] an expansion of the fraud exception . .

[7] Historically, when this Court has meant to discuss direct claims, it has said so explicitly. *See, e.g., Feldman*, 951 A.2d at 731; *Gentile v. Rossette*, 906 A.2d 91, 97 n.12 (Del. 2006); *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766, 769 (Del. 2006).

. that would effectively swallow that rule," as feared by the *Villari* court. 208 Cal. App. 4th at 1485.

The Countrywide merger presents a unique set of facts that render any attempt to distinguish the original fraud from the merger that it forced particularly fruitless. Plaintiffs allege that during the relevant period, the Defendants embarked on a fraudulent scheme that engulfed the Company's principal operations, with the inevitable and foreseeable consequence of the ultimate collapse of the company. At the heart of the scheme, Defendants issued loans that not only would not be repaid, but that actually were designed to provide greater (paper) profits to Countrywide *the further the borrowers' fell behind*. Complaint ¶¶17-18 (App A000015-16). In other words, for its success, the scheme *depended* on loans to borrowers who would be unable to repay. *See id.* ¶¶121, 171-173, 193 (App. A000051; A000069; A000076). These greater reported profits were what enabled Defendants to claim Countrywide's assets for themselves in the form of bonus payments, insider trading, and, ultimately, tens of millions of dollars in change-of-control payments stemming from the merger. *See id.* ¶¶1,14, 29-32, 39, 138, 171, 321-340, 356 (App. A000001; A000014; A000019-20; A000022-23; A000057-58; A000069; A000128-138; A000143). Thus, this was not simply a fraudulent scheme that damaged the company and made a merger advisable – this was a wholesale corruption of the company's core business in service of a scheme that had as its natural and *predictable* conclusion the ultimate destruction of the company. *See Arkansas Teachers*, 996 A.2d at 323 ("TRS has pleaded facts supporting

a colorable claim of fraud that, if proved, would have made the company's dissolution or auction a *fait accompli*.”).

Because of this scheme, Countrywide was placed in such dire straits that shareholders were forced to accept any merger offer to salvage what little corporate wealth remained – even if that meant indemnifying the Defendants for the very destruction of corporate assets that made the merger necessary. *Cf. In re Countrywide Corp. S’holders Litig.*, 2009 WL 2595739, at *3 (Del. Ch. Aug. 24, 2009) (“*Countrywide III*”) (“There is no evidence of any other potential acquirer. It appears from the record that, but for the BOA acquisition, the Countrywide shareholders would have faired (even more) poorly.”); *Countrywide II*, 2009 WL 846019, at *8 (“There is no suggestion that any entity other than BOA was interested in (or capable of) acquiring Countrywide. . . . In the absence of an acquisition, the fate of Countrywide might well have been bleak.”). These circumstances are particularly rare, and when they exist, an inquiry into whether the merger was sought *solely* to eliminate the directors’ liability, or whether the directors arranged circumstances so that a fire sale merger would be the inevitable result serving multiple goals serves no purpose, as this Court recognized. *See Arkansas Teachers*, 996 A.2d at 323.

E. Public Policy Requires that Plaintiffs Be Permitted to Continue to Pursue Their Derivative Claims

Where systemic fraud and mismanagement by corporate directors and officers results in the financial collapse of the corporation and near complete destruction of shareholder value, necessitating a fire sale of the company at a price that reflects the destruction to corporate

value wrought by significant breaches of fiduciary duty, public policy demands that the right to pursue derivative claims for those breaches remain in the hands of the shareholders who suffered the injury. In these exceptionally rare circumstances, shareholders of the damaged corporation who seek to prosecute those claims should not be deprived of standing simply because the merger, rendered inevitable by the very fraud that forms the basis of those claims, closes. To hold otherwise would ignore the economic realities of the situation, allow corporate fiduciaries who plainly abused their office for personal profit to escape liability for their malfeasance, and provide perverse incentives for corporate directors seeking to protect themselves from personal liability.

1. The Economic Injury Resides With Countrywide's Former Shareholders

In late 2007, Countrywide's stock price collapsed as the details of systemic fraud and breaches of fiduciary duties committed by the Company's directors and senior management became known to the public. Defendants' misconduct left the Company in such a state that the merger was their only option short of bankruptcy. *See Arkansas Teachers*, 996 A.2d at 324 (recognizing that Defendants' fraud "necessitated" a "fire sale" merger). The economic injury that resulted from those events fell upon Countrywide's former shareholders, who had no choice but to sell their shares at a deeply depressed price, and who have never been compensated for the damage wrought by the individual defendants' actions in decimating what was once the world's leading mortgage company.

Under such circumstances, it is Countrywide's former shareholders - and not its acquirer – who should be permitted to control any derivative action against Countrywide. Unlike in an ordinary merger, Countrywide's former shareholders were forced to accept a deal by the fraudulent conduct of the Company's prior managers. They did not willingly choose to rest their fortunes with BofA, who did not suffer the same injuries. It is therefore unfair to make their potential recoveries subject to the business judgment of BofA, which – having not suffered from the fraud and having not paid for the value of the derivative claims – will have very different priorities.

Indeed, Delaware courts have long held that an acquiring corporation may *not* pursue derivative claims held by the target entity when it is plain that the acquiring company did not pay for them or suffer any harm. This doctrine, first articulated in *Bangor*, was explained by this Court:

> [W]here shareholders have purchased all or substantially all of the shares of a corporation at a fair price, they have personally sustained no injury from wrongs which occurred prior to their purchase, and consequently, any recovery on their part for such prior wrongs would constitute a windfall and would enable such shareholders to obtain funds to which they had no just title or claim. In addition, to allow recovery to subsequent shareholders for prior wrongs would permit them to recoup a large part of the price they agreed to pay for their shares even though they had received all they had bargained for.

Courtland Manor, Inc. v. Leeds, 347 A.2d 144, 147 (Del. Ch. 1976); *see also Midland Food Services, LLC v. Castle Hill Holdings V, LLC*, 792 A.2d 920, 930 (Del.Ch. 1999)(the purpose of the *Bangor Punta* Doctrine is to "prevent persons from being able to re-trade arms-length transactions by using the corporation to sue the parties from whom

they obtained their shares"); *Atlantis Plastics Corp. v. Sammons*, 1988 WL 32371, at *2-3 (Del. Ch. Mar. 30, 1988) (current stockholders cannot bring breach of fiduciary duty claim against former directors of company whose stock they own because they did not own shares of the company at the time of the alleged misconduct).

To allow BofA – even if it wanted to (which it has made clear it does not) – to take over the Plaintiffs' derivative claims would essentially throw out the long-established policies underlying these cases. *See Courtland Manor*, 347 A.2d at 148 (allowing a corporation to recover more than $70,000 in damages that sought from former senior officer for mismanagement held inequitable because corporation's primary shareholders will have acquired for "some $19,000 a corporation worth some $90,000, and thus a benefit far in excess of that which they bargained for when they undertook to acquire by far the majority ownership of a foundering corporation.") Instead, allowing individual shareholders post-fraud/post-merger continued standing to pursue their derivative claims that pre-date the merger is consistent with this established policy.

Nor is there material risk that, in future hypothetical cases, the acquiring company might in fact pay for the derivative claims (unlike BofA here), and therefore be unjustly deprived of the value of the claims if shareholder derivative standing is allowed to continue. This is because in a situation where a single fraudulent scheme destroys the value of a company and necessitates a merger, the

directors will not sell to an entity that intends to sue them or that provides them with less than full legal protection.[8]

2. Depriving Countrywide's Former Shareholders of the Ability To Prosecute The Derivative Claims Would Allow Defendants To Escape Liability Entirely

Any holding that Countrywide's fire sale to BofA deprived Countrywide's former shareholders of standing to prosecute the derivative claims would, for all practical purposes, eliminate the claims entirely and allow Defendants to escape liability for their fraudulent conduct and massive breaches of fiduciary duty.

Although the Merger closed in 2008, BofA has made no effort to prosecute the derivative claims, nor has it expressed any interest in doing so. In approving the settlement of the deal case challenging the Merger, the Chancery Court flatly acknowledged that BofA had no interest in pursuing the derivative claims. *Countrywide II*, 2009 WL 846019, at *8 ("[T]he more reasonable inference is that BOA had no

[8] Indeed, here, the contractual terms of the sale arguably preclude BofA from being able to effectively prosecute any derivative claims that theoretically may have been transferred to BofA upon its acquisition of Countrywide. Section 6.7 of the governing Agreement and Plan of Merger specifically requires BofA to indemnify and hold harmless any officers and directors of Countrywide from any claims that have, or may be, asserted against them arising from their service as an officer or director of Countrywide. *See* Agreement and Plan of Merger by and among Countrywide Financial Corporation, Bank of America Corporation, and Red Oak Merger Corporation, Dated as of January 11, 2008, and filed as Exhibit 2.1 to the SEC Form 8-K filed by Countrywide on January 17, 2008, at § 6.7(a) (BofA and Countrywide "shall cooperate and use their best efforts to defend against and respond" to "any threatened or actual claim, action, suit, proceeding, or investigation, whether civil, criminal or administrative.") & § 6.7(b) (BofA shall, "to the fullest extent permitted by applicable law, indemnify, defend and hold harmless, and provide advancement of expenses to [Countrywide's officers and directors] against all losses, claims, damages, costs, expenses, liabilities or judgments or amounts that are paid in settlement.").

interest in pursuing any derivative claim that it might have acquired along with its acquisition of Countrywide."). In fact, BofA had a strong economic *disincentive* to prosecute the derivative claims. With the acquisition, BofA inherited Countrywide's vast liabilities in a variety of areas, including the federal securities class action that sought to impose billions of dollars in liability on the Company. Were BofA to have openly accused Countrywide's former directors and officers of fraud, BofA would have admitted liability on the securities claims. Ultimately, BofA settled the securities class action for a payment of $600 million, under an agreement that expressly disclaimed liability. *See In re Countrywide Financial Corp. Sec. Litig.*, No. CV 07-05295 MRP (MANx) (C.D. Ca.)(Doc. 841), Amended Stipulation and Agreement of Settlement at 8 (App. A000240)("WHEREAS, Defendants expressly deny that they have committed any act or omission giving rise to any liability or violation of law whatsoever, and state that they are entering into this settlement solely to eliminate the uncertainties, burden, risk and expense of further litigation;. . .").

3. Depriving Plaintiff of Post-Merger Standing Here Would Create Perverse Incentives For Corporate Fiduciaries

"Although equity is and long has been in every sense of the word a system, and although it is impossible that any new general principles should be added to it, ... the truth stands, and always must stand, that the final object of equity is to do right and justice." *Schoon v. Smith*, 953 A.2d 196, 205 (Del. 2008). Denial of standing to Countrywide's former shareholders to pursue the derivative claims against the likes of Angelo Mozilo creates perverse incentives

for corporate fiduciaries: Your fraudulent conduct may expose you to liability, unless, like Mozilo, your conduct takes the company to the brink of failure and the only solution is to sell it to another company, in which case you can evade liability. This ***cannot*** be the message this Court wants to send to corporate fiduciaries.

As the Chancery Court recently observed in discussion of this Court's expansion of double derivative standing:

> If derivative actions promote firm value, even marginally, then a rule that forecloses some number of both meritorious and meritless derivative actions will, all things being equal, inherently transfer some degree of wealth from corporations to the individuals who commit corporate wrongs. . . The resulting wealth transfer confers a windfall on faithless fiduciaries and creates perverse incentives for misbehavior. . . At the same time, the risk that a plaintiff would invest resources in a viable claim only to lose standing through a merger dis-incentivizes stockholders from engaging in monitoring under circumstances where it is already "likely that in a public corporation there will be less shareholder monitoring expenditures than would be optimum from the point of [view of] the shareholders as a collectivity."

Hamilton Partners, L.P. v. Englard, 11 A.3d 1180, 1206 (Del. Ch. 2010), *quoting Bird v. Lida, Inc.*, 681 A.2d 399, 403 (Del. Ch. 1996). Denial of Plaintiffs' continued derivative standing under the circumstances here would not only deprive them of any compensation for the extraordinary wrongdoings by Countrywide's top executives and directors — misconduct that this Court recognized "necessitated a fire sale merger" (*Arkansas Teachers*, 996 A.2d at 324) — it would incentivize fiduciaries to commit fraudulent acts with such abandon that they economically destroy the company leaving a sale of the company the only remaining option – knowing that all derivative claims against them will be merged out of existence. Undoubtedly, avoiding

such a result is the reason this Court first recognized the fraud exception in *Anderson*. The facts of this case demand the same response. To permit Defendants to indemnify themselves for their own fraud at the expensive of Countrywide and its shareholders is abhorrent to all notions of equity.

CONCLUSION

For the foregoing reasons, the certified question should be answered in the affirmative. Plaintiffs should be permitted to pursue their derivative claims against Defendants.

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Respectfully submitted,

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