IN THE SUPREME COURT OF THE STATE OF DELAWARE

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

ANSWERING BRIEF OF NOMINAL DEFENDANT-APPELLEE COUNTRYWIDE FINANCIAL CORPORATION

Of Counsel:

Brian E. Pastuszenski
Goodwin Procter LLP
53 State Street
Boston, MA 02109

Daniel P. Roeser
Goodwin Procter LLP
620 Eighth Avenue
New York, NY 10018

Jason L. Krajcer
Teodora E. Manolova
Goodwin Procter LLP
601 S. Figueroa Street
Los Angeles, CA 90017

Thomas A. Beck (#2086)
Richard P. Rollo (#3994)
J. Scott Pritchard (#5654)
Richards, Layton & Finger, P.A.
One Rodney Square
920 North King Street
Wilmington, DE 19801
(302) 651-7700

Attorneys for Countrywide Financial Corporation

Dated: March 18, 2013

TABLE OF CONTENTS

Page

TABLE OF CITATIONS

Page(s)

CASES

STATUTES & RULES

NATURE OF PROCEEDINGS

The Ninth Circuit has asked this Court to determine whether shareholders may invoke the "fraud exception" to the continuous ownership rule governing post-merger derivative standing merely 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." Ex. A. From this Court's decision in *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), to its decision in *Lambrecht v. O'Neal*, 3 A.3d 277 (Del. 2010), this Court's rulings for 26 years have provided the same answer to this question: "No." In each of those decisions this Court held that the fraud exception applies ***only*** when the ***sole*** purpose of a merger is to extinguish shareholders' derivative standing.

Seizing on *dicta* that concerns *direct* (not derivative) claims in *Arkansas Teacher Ret. System v. Caiafa*, 996 A.2d 321 (Del. 2010), Plaintiffs seek to gut both the continuous ownership rule and the fraud exception. Although Plaintiffs admit that this Court's decisions have applied "a strict rule against continuing derivative standing post-merger" with only a narrow fraud exception, they nevertheless argue that this Court "clarified in *Arkansas Teacher*" that the fraud exception is not strictly limited to fraud associated with the merger itself. Br. at 2. They now contend that the fraud exception applies more broadly to fraudulent pre-merger conduct that necessitated the merger. *Id.* Neither the plain language of *Arkansas Teacher*, nor the policies behind the continuous ownership rule and the fraud exception, nor the equities support this argument. This Court should answer the certified question from the Ninth Circuit in the negative.

SUMMARY OF ARGUMENT[1]

1. Beginning with *Anderson*, this Court has held in an unbroken line of cases spanning some 26 years that the fraud exception applies only when a merger's sole purpose is to extinguish shareholders' derivative standing.

2. *Arkansas Teacher*'s *dicta* did not change the bedrock principles of Delaware corporate law. *First*, Plaintiffs' current position that *Arkansas Teacher* merely "clarified" the fraud exception is inconsistent with both their prior position in this case that it represented "a new material change of law" and with a prior position taken by one of the Lead Plaintiffs in other litigation where it interpreted *Arkansas Teacher* the same way that Nominal Defendant-Appellee Countrywide Financial Corporation ("Countrywide") does here. *Second*, *Arkansas Teacher* did not "clarify," "expand," or constitute "a new material change" to *Anderson*'s fraud exception, but rather unambiguously applied the existing fraud exception. *Third*, *Arkansas Teacher*'s *dicta* about "inseparable fraud" referred to *direct* rather than *derivative* claims, as this Court's citations to *Braasch v. Goldschmidt*, 199 A.2d 760 (Del. Ch. 1964), its description of a classically direct claim under *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and this Court's later decision in *Lambrecht*, 3 A.3d 277, make clear. *Fourth*, *Arkansas Teacher*'s *dicta* did not *sub silentio* abrogate

[1] Because Plaintiffs' Summary of Argument section lacks numbered paragraphs setting forth the legal propositions upon which each side relies, Defendants cannot individually admit or deny the legal propositions in each paragraph as contemplated by Delaware Supreme Court Rule 14(b)(iv). Plaintiffs' arguments all reduce to the legal proposition that this Court's *dicta* in *Arkansas Teacher* expanded the fraud exception. That legal proposition is denied for the reasons stated herein.

8 *Del. C.* § 259(a), which would be the necessary result were Plaintiffs' reading correct.

3. *Arkansas Teacher*'s *dicta* did not create a broad fraud exception that would swallow *Anderson*'s continuous ownership rule. Plaintiffs' interpretation would turn the policy behind the continuous ownership rule on its head by allowing shareholders to intrude on a corporate board's powers even where (as here) those shareholders no longer have any interest in obtaining legal redress for the benefit of the corporation, but rather only for themselves. It would convert that rule into a highly subjective and unpredictable inquiry, which would create uncertainty for corporations, directors, managers, and shareholders. It would chill merger transactions, potentially causing directors not to engage in mergers that would be in shareholders' best interests. And it would lead to confusion and inconsistency in the case law, disrupting settled expectations regarding merger practice and increasing transaction and litigation costs.

4. Contrary to Plaintiffs' argument, *Anderson*'s continuous ownership rule does not leave shareholders without remedies for any supposed wrongs. Indeed, *Anderson* itself rejected this very argument, applying the continuous ownership rule despite the plaintiff's professed fear that it would leave wrongs unremedied. Moreover, the former Countrywide shareholders already have availed themselves of other remedies, including recovery of $624 million through a settlement of direct securities claims based on factual allegations identical to those in this case and assertion of double-derivative claims on behalf of Countrywide's parent entity, Bank of America Corporation ("BofA").

COUNTERSTATEMENT OF FACTS

A. Plaintiffs' Derivative Claims Are Dismissed.

Plaintiffs, all former Countrywide shareholders, filed this derivative action in October 2007 in the Central District of California. B74.[2] On January 11, 2008, Countrywide agreed to merge with a subsidiary of BofA in a stock-for-stock transaction valued at approximately $4 billion—a transaction that the Chancery Court found "at least fair" to Countrywide's former shareholders. B70, B103. On July 1, 2008, following approval by Countrywide's shareholders, the merger closed. B74. All outstanding Countrywide shares were exchanged for BofA shares, and all Countrywide shareholders at the time of the merger became shareholders of BofA. Countrywide was merged into BofA's acquisition subsidiary, which remained a wholly-owned subsidiary of BofA without any public shareholders. Ex. E at 9.

Defendants then moved in the District Court for judgment on the pleadings as to Plaintiffs' derivative claims on the ground that Plaintiffs lost derivative standing when, as a result of the merger, they ceased to be Countrywide shareholders. B28-37. Opposing the motion, Plaintiffs took the position that federal (not Delaware) law governed their derivative standing and asked the District Court to make an "equitable exception" to the federal (not Delaware) continuous

[2] B1-136 of Countrywide's Appendix are documents excerpted from the Ninth Circuit record. B137-257 of Countrywide's Appendix are documents from other judicial proceedings or documents published by the Securities and Exchange Commission ("SEC"), of which Countrywide seeks judicial notice pursuant to D.R.E. 201. *See, e.g.*, *In re Cabell*, 935 A.2d 255, 2007 WL 2713264, at *1 n.6 (Del. Sept. 19, 2007) (TABLE) (taking judicial notice of various court filings); *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006) (judicial notice of SEC filings is appropriate).

ownership requirement. B49-50. Plaintiffs expressly challenged the applicability of Delaware's continuous ownership rule and never even attempted to argue that they could satisfy the fraud exception. B49-63. On December 11, 2008, the District Court granted Defendants' motion for judgment on the pleadings and dismissed all derivative claims, holding that the merger had extinguished Plaintiffs' derivative standing under both federal and Delaware law. Ex. E at 8-13.

B. Plaintiffs' Direct Claims Are Released.

After Countrywide and BofA had agreed to the merger, Plaintiffs amended their complaint to add direct merger-related class claims. B74. The District Court stayed Plaintiffs' direct claims in favor of similar claims on behalf of the same putative class that were pending in the Chancery Court. B1-27. Following the announcement of an agreement to settle the merger-related claims in Delaware, the District Court ordered Plaintiffs to address any objections concerning the release of the direct merger-related claims to the Chancery Court. B43. Plaintiffs later objected to the settlement, arguing that it would improperly release their direct claims—*i.e.*, their claims that Countrywide's directors had breached duties both to "value" Plaintiffs' shareholder derivative claims separately by carving them out of the merger and to "preserve" the value of those derivative claims "either by extracting additional consideration from BOA or by assigning the derivative claims to a litigation trust that could pursue the claims for the benefit of Countrywide's shareholders." B84.

On March 31, 2009, based on its review of an extensive discovery record of more than 400,000 pages of documents, the Chancery Court

overruled Plaintiffs' objection. B65-105. The Chancery Court held that Plaintiffs' direct "failure-to-value" and "failure-to-preserve" claims were unsupported by Delaware law and thus "functionally worthless." B90. The Chancery Court also held that the settlement was "fair" and "reasonable" to the proposed class despite the release of such claims, making a number of factual findings about the Countrywide board's reasons for approving the merger. Most importantly:

- The Chancery Court found that the merger had not been motivated by any desire to eliminate derivative standing but rather by economic necessity. "[A]voiding derivative liability was neither the only nor the principal reason for supporting the transaction." B83.
- The Chancery Court found that the merger consideration received by Countrywide shareholders was fair. "[T]here is precious little doubt that the consideration received by the Countrywide shareholders was anything other than at least fair." B103.[3]

Plaintiffs appealed from the Chancery Court's final judgment approving the settlement. This Court affirmed that judgment, finding: "The Vice Chancellor appropriately denied the objection, because Delaware corporate fiduciary law does not require directors to value or preserve piecemeal assets in a merger setting, and [Plaintiffs] failed to show a likelihood of prevailing on the merits of [their] claims." *Arkansas Teacher*, 996 A.2d at 322. In the very first paragraph of its

[3] In contrast to the factual findings about the merger, there have been no factual findings by any court or other tribunal about the "inseparable fraud" asserted by Plaintiffs. Plaintiffs' allegations are just that, allegations.

opinion, this Court stated that the closing of the merger had terminated Plaintiffs' standing to pursue derivative claims under long-standing Delaware law:

> 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.*** Because the Vice Chancellor did not abuse his discretion by holding that [Plaintiffs'] derivative suit claims for breach of asserted duties were worthless and, therefore, added no conceivable value to the merger, we **AFFIRM** his judgment approving the settlement.

Id. (first emphasis added).

The Court then speculated in *dicta* regarding certain direct claims that Plaintiffs could have, but did not, present to the Chancery Court. *Id.* at 322-24. In particular, the Court stated that Plaintiffs theoretically could have pled a claim for "a single, inseparable fraud" alleging that pre-merger fraudulent conduct made the merger "a *fait accompli*." *Id.* at 323. The Court stated that, in any such claim, "the injured parties would be the shareholders who would have post-merger standing to recover the damages instead of the corporation." *Id.* at 324. The Court noted, however, that Plaintiffs "did not present this claim to the Vice Chancellor," and therefore held "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 BOA's acquisition, and arguably necessitated a fire sale merger." *Id.* at 323-24.

C. Plaintiffs Seek Reconsideration Of The Dismissal Of Their Derivative Claims.

Following this Court's decision in *Arkansas Teacher*, Plaintiffs moved for reconsideration of the District Court's order granting judgment on the pleadings. B106-36. Plaintiffs turned 180 degrees and, in direct contradiction to their earlier argument, asserted that Delaware law rather than federal law governed their post-merger derivative standing. B125-36. Plaintiffs then argued that this Court's *dicta* in *Arkansas Teacher* represented "a new material change of law" that "expanded the post-merger standing fraud exception to include situations where, as here, plaintiffs sufficiently allege fraudulent conduct that necessitated that merger." B125, B127 (internal quotation marks omitted). Plaintiffs conceded that, before *Arkansas Teacher*'s *dicta*, they had not fit within the fraud exception. B123-27.

The District Court denied Plaintiffs' motion for reconsideration, holding that this Court's *dicta* "did not change Delaware law regarding the loss of derivative standing after a merger":

> [T]he Delaware Supreme Court relied on established Delaware law and affirmed the decision of the Vice Chancellor on the basis of the reasons in his opinion, because the record did not support a finding that avoiding derivative liability was the principal reason for the Countrywide Board of Directors' approval of the merger with Bank of America. Moreover, the Delaware Supreme Court acknowledged that its approval of the settlement extinguished standing to bring derivative claims on behalf of Countrywide.

Ex. D at 2 (citations omitted). The District Court also found that this Court's *dicta* simply confirmed longstanding Delaware law that "***shareholders***—not the corporation via a derivative suit—would have had post-merger standing to recover damages from a ***direct*** fraud claim, if

one had been properly pleaded." Ex. D at 2 n.2 (emphasis in original).

Following the District Court's order denying Plaintiffs' motion for reconsideration and dismissing the case, Plaintiffs appealed to the Ninth Circuit, which certified the question now before this Court.

D. Plaintiffs And Other Former Countrywide Shareholders Receive $624 Million To Redress Alleged Wrongs.

Although Plaintiffs' derivative claims were dismissed for lack of standing, former Countrywide shareholders—including one of the Plaintiffs—have used other remedies to receive ***$624 million*** for the same alleged wrongs at issue in Plaintiffs' derivative complaint here. More specifically, former shareholders brought a securities class action based on the same factual allegations of fraud at issue here[4] and received a $624 million settlement. *See* B218-49.[5]

---

[4] *Compare, e.g.*, *In re Countrywide Fin. Corp. Deriv. Litig.*, Lead Case No. 2:07-CV-6923-MRP (MANx) (C.D. Cal. Feb. 15, 2008) (Consoli-dated Shareholder Derivative Action And Class Action Complaint, Dkt. No. 41), A9-24 at ¶¶ 1-42 *with In re Countrywide Fin. Corp. Sec. Litig.*, Lead Case No. 2:07-5295-MRP (MANx) (C.D. Cal. Jan. 6, 2009) (Second Consolidated Amended Class Action Complaint For Violations Of The Federal Securities Laws, Dkt. No. 325), B149-55 at ¶¶ 1-15.

[5] In addition, former shareholders received another ***$48 million*** in recoveries from a record SEC settlement with certain former Countrywide officers. *See* B180-82, B250-57. (The notional settlement amount was $73 million, $25 million of which reflected monies previously paid in the securities class action settlement, thereby providing an incremental settlement benefit of $48 million.) In total, former Countrywide shareholders, including Plaintiffs, have received ***$672 million.***

ARGUMENT

THIS COURT SHOULD ANSWER THE CERTIFIED QUESTION IN THE NEGATIVE AND REJECT PLAINTIFFS' INVITATION TO CREATE A FRAUD EXCEPTION THAT WOULD SWALLOW THE CONTINUOUS OWNERSHIP RULE ESTABLISHED IN *ANDERSON* AND APPLIED BY DELAWARE COURTS FOR NEARLY 30 YEARS.

I. QUESTION PRESENTED.

The Ninth Circuit certified the following question to this Court:

> 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.

Ex. A at 3.

II. SCOPE OF REVIEW.

The standard of review is *de novo* for the certified question of law before this Court. *See, e.g.*, *Lambrecht*, 3 A.3d at 281.

III. MERITS OF ARGUMENT.

A. For Nearly 30 Years, This Court Has Consistently Applied The Fraud Exception *Only* When The *Sole* Purpose Of A Merger Was To Extinguish Derivative Standing.

Anderson's continuous ownership requirement—including the fraud exception—represents "a procedural restatement of the bedrock principles of Delaware corporate governance in the context of *standing* to maintain a derivative shareholder's suit." *Ala. By-Prods. Corp. v. Cede & Co. ex rel Shearson Lehman Bros.*, 657 A.2d 254, 265 (Del. 1995) (alteration omitted; emphasis in original). It is an "iron-clad rule." *Ash v. McCall*, 2000 WL 1370341, at *12 (Del. Ch. Sept. 15, 2000). Beginning with *Anderson*, this Court has held in an unbroken line of cases—before, including, and after *Arkansas Teacher*—that the fraud exception applies only when the sole purpose of a merger is to

extinguish shareholders' derivative standing:

- ***Lewis v. Anderson***: This Court held that the fraud exception did not apply because "[p]laintiff has not asserted that the merger was perpetrated to deprive [the acquired corporation] of its claim against the individual defendants." 477 A.2d at 1046 n.10.
- ***Kramer v. W. Pac. Indus.***: This Court held that the fraud exception applies only "if the merger itself is . . . being perpetrated merely to deprive shareholders of the standing to bring a derivative action." 546 A.2d 348, 354 (Del. 1988).
- ***Lewis v. Ward***: "Although subsequent cases have paraphrased this Court's language in *Lewis v. Anderson*, the substance remains the same—a complaint seeking to invoke the fraud exception must demonstrate that the merger was fraudulent and done merely to eliminate derivative claims." 852 A.2d 896, 905 (Del. 2004).
- ***Feldman v. Cutaia***: This Court held that the fraud exception applies only "if the merger itself is . . . being perpetrated merely to deprive shareholders of the standing to bring a derivative action." 951 A.2d 727, 731 & n.20 (Del. 2008).
- ***Arkansas Teacher Retirement System v. Caiafa***: This Court held that "[a] stockholder may maintain his post-merger suit 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." 996 A.2d at 323 (internal quotation marks omitted).
- ***Lambrecht v. O'Neal***: After its opinion in *Arkansas Teacher*, this Court reaffirmed that the fraud exception applies only "where the

merger itself is . . . being perpetrated merely to deprive shareholders of their standing to bring the derivative action." 3 A.3d at 284 n.20.

Thus, from *Anderson* to *Lambrecht*, this Court repeatedly has reaffirmed the narrow scope of the fraud exception and its requirement that the sole purpose of a merger be to extinguish derivative standing. And for good reason. The continuous ownership rule—including the fraud exception—is based on bedrock principles of the Delaware General Corporation Law. *See supra* at 10-11. As this Court explained in *Anderson*, 8 *Del. C.* §§ 259, 261 and 327, "read individually and collectively, permit one result which is not only consistent but sound: A plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit." 477 A.2d at 1049. Indeed, the continuous ownership rule is "a logical corollary to the established principle of Delaware corporate law recognizing the separate corporate existence and identity of corporate entities, as well as the statutory mandate that the management of every corporation is vested in its board of directors, not in its stockholders." *Ward*, 852 A.2d at 903. None of the statutory mandates has changed since *Anderson*, and neither has the continuous ownership rule grounded in them.

B. *Arkansas Teacher*'s *Dicta* Did Not Change Bedrock Principles Of Delaware Corporate Law.

1. Plaintiffs' Current Position Is Inconsistent With Their Prior Positions In This And Other Cases.

The interpretations of *Arkansas Teacher* that Plaintiffs have advanced in this case have been all over the map, shifting to suit the

litigation needs of the moment. In their opening brief to this Court, Plaintiffs argue that *Arkansas Teacher* merely "clarified" the fraud exception, which they assert still "remains narrow." Br. at 2, 25. In contrast, in their motion for reconsideration before the District Court, Plaintiffs argued that *Arkansas Teacher* represented "a new material change of law" that "expanded the post-merger standing fraud exception to include situations where, as here, plaintiffs sufficiently allege fraudulent conduct that necessitated the merger." *See* B125, B127 (internal quotation marks omitted). Although both of Plaintiffs' interpretations are incorrect, Plaintiffs are right about one thing: if this Court were to redefine the fraud exception to include "inseparable fraud" claims, it would not remotely resemble any kind of "clarification" but would represent a "material change of law."

Not only is Plaintiffs' current position inconsistent with their prior position in this case, it is directly at odds with the position Lead Plaintiff Louisiana Municipal Police Employees' Retirement System ("LAMPERS") took in prior litigation, in which it interpreted *Arkansas Teacher* the same way Countrywide does here. In *In re Barnes & Noble Stockholder Derivative Litigation*, C.A. No. 4813-VCS (Del. Ch. 2010), LAMPERS filed a derivative action against Barnes & Noble's ("B&N's") officers and directors for breach of fiduciary duty in connection with B&N's acquisition of Barnes & Noble College Booksellers, Inc. *See* B186-91. LAMPERS moved for expedited proceedings, arguing that the acquisition had devastated B&N's stock price and put B&N itself at risk of being acquired at a fire-sale price that allegedly would de-

stroy any ability to recover on the derivative claims. *Id.* Defendants opposed expedited treatment, arguing that the plaintiffs would not lose the ability to bring direct claims. B196-205. Although Plaintiffs now argue that "this Court's discussion [in *Arkansas Teacher*] makes no sense as an examination of direct claims," Br. at 25, LAMPERS admitted in responding to the B&N defendants that this Court in *Arkansas Teacher* was actually referring to direct—not derivative—claims. In doing so, LAMPERS cited the same "inseparable fraud" language in *Arkansas Teacher* that is at issue here and forms the basis of Plaintiffs' appeal:

> [T]he existence of any ***direct*** claim appears to be based on the Delaware Supreme Court's decision in *Arkansas Teacher Retirement System v. Caiafa*, 996 A.2d 321 (Del. 2010). There, the Court suggested, largely in *dicta*, that derivative plaintiffs might have ***direct*** claims against directors post-merger if the plaintiffs could establish that the directors' improper premerger conduct both caused a depressed stock price and ultimately necessitated a merger at that diminished price. *Id.* at 324. But the Supreme Court indicated that such claims would likely only exist under a very specific scenario in which the directors' conduct was fraudulent or intentional. *Id.* at 323-24. Thus, it is not at all clear that Plaintiffs would have ***such direct*** claims in the event B&N is sold.

B212 (emphasis added and removed). Plaintiffs' current reading of *Arkansas Teacher* is thus contradicted by both the Court's plain language in *Arkansas Teacher* and LAMPERS' own prior reading of it.

2. ***Arkansas Teacher*** Applied ***Anderson***'s Continuous Ownership Rule.

Arkansas Teacher did not "clarify," "expand," or constitute "a new material change" in *Anderson*'s continuous ownership rule or the fraud exception. Rather, in the very first paragraph of *Arkansas Teacher*—*i.e.*, the portion that is not *dicta*—this Court unequivocally

held that the Countrywide-BofA merger extinguished Plaintiffs' derivative standing: "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***." 996 A.2d at 322 (emphasis added).

As the California Court of Appeal and the District Court have both recognized, this Court's plain language in *Arkansas Teacher* states that former Countrywide shareholders have no standing to maintain a derivative action on Countrywide's behalf. More specifically, the Court of Appeal held: "*Arkansas Teacher*, in the very first paragraph of the opinion, ***effectively recognized the continuing viability of the* Anderson *continuous ownership rule and the absence of any applicable exception thereto*** based on the facts alleged in this case." *Villari v. Mozilo*, 208 Cal. App. 4th 1470, 1484 (Cal. Ct. App. 2012) (emphasis added).[6] Likewise, the District Court concluded: "[*Arkansas Teacher*] did not change Delaware law regarding the loss of derivative standing after a merger. To the contrary, the Delaware Supreme Court relied on established Delaware law and . . . . ***acknowledged that its approval of the settlement extinguished standing to bring derivative claims on behalf of Countrywide***." Ex. D at 2 (emphasis added).

Plaintiffs characterize this Court's words in *Arkansas Teacher* as "a summary of the basis for Plaintiffs' objection to the class action settlement." Br. at 21. That characterization, however, cannot be squared with this Court's plain language. Unambiguously applying *An-*

[6] *Villari* was a shareholder derivative action filed in California state court that raised "essentially the same claims" as those asserted in the District Court. *Villari*, 208 Cal. App. 4th at 1474.

derson's continuous ownership requirement, including the fraud exception, this Court unequivocally stated that Countrywide's merger with BofA had extinguished Plaintiffs' standing to pursue derivative claims. *Arkansas Teacher*, 996 A.2d at 322. The Court thereby reaffirmed that *Anderson*'s narrow fraud exception remained the law of Delaware. But if there were any doubt as to whether this reading of *Arkansas Teacher* is correct (and there is not), this Court's decision in *Lambrecht* put it to rest. There, just three months after *Arkansas Teacher* was decided, this Court once again reaffirmed that *Anderson*'s fraud exception applies only in the limited circumstance "where the merger itself is . . . being perpetrated merely to deprive shareholders of their standing to bring the derivative action." *Lambrecht*, 3 A.3d at 284 n.20. As the California Court of Appeal said, "If *Arkansas Teacher* is to be read as plaintiff argues, then *Lambrecht*'s reaffirmance of *Anderson* without mentioning *Arkansas Teacher* would be very puzzling indeed." *Villari*, 208 Cal. App. 4th at 1484.

3. ***Arkansas Teacher*'s *Dicta* About "Inseparable Fraud" Referred To Direct Claims.**

After holding that the Countrywide-BofA merger extinguished Countrywide shareholders' standing to pursue derivative claims, this Court in *dicta* discussed certain direct claims that Plaintiffs could have brought (but did not). According to Plaintiffs, that *dicta* overruled *sub silentio* some 26 years of consistent decisions from this Court holding that the fraud exception applies only when the sole purpose of a merger is to extinguish shareholders' derivative standing. Plaintiffs' current argument, however, is contradicted not only by the holding of *Arkansas Teacher* (*i.e.*, that the Chancery Court's approval

of the merger extinguished Plaintiffs' derivative standing) and LAMPERS' own prior reading of this Court's decision, but also by the language and reasoning of the *dicta* itself. In its discussion of "inseparable fraud," this Court made clear that it was referring to ***direct***, not derivative, claims (and, accordingly, was not even addressing—let alone expanding—the *Anderson* exception at all).

(a) This Court Expressly Reaffirmed The Fraud Exception To The Continuous Ownership Rule.

This Court began its discussion by reaffirming the narrow scope of the fraud exception as set forth in *Anderson* and its progeny. Quoting *Kramer*, 546 A.2d at 354, and *Ward*, 852 A.2d at 902, this Court reiterated that "[a] stockholder may maintain his post-merger suit '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.'" *Arkansas Teacher*, 996 A.2d at 323 (emphasis added). This Court then explained that the conditions necessary to satisfy the fraud exception were not present in this case because the record did "not reflect that the [Countrywide] directors prospectively sought and approved a merger, solely to deprive stockholders of standing to bring a derivative action." *Id.* As this Court recognized, "[t]he Vice Chancellor noted that avoiding derivative liability was neither the only nor the principal reason for supporting the transaction." *Id.* (internal quotation marks omitted). *Arkansas Teacher* did not change the scope of the fraud exception.[7]

[7] Plaintiffs assert that the fraud exception articulated in both *Anderson* and *Arkansas Teacher* was based on the language in *Bokat v. Getty Oil Co.* that, "[i]f a proposed merger is sought to be used for the

Plaintiffs cite two cases for the proposition that this Court found the facts of *Arkansas Teacher* to fall within the scope of the fraud exception, *In re Massey Energy Co.*, 2011 WL 2176479 (Del. Ch. May 31, 2011), and *In re Bear Stearns Cos. Securities, Derivative & ERISA Litigation*, 2011 WL 4063685 (S.D.N.Y. Sept. 13, 2011). Br. at 19-20. Both decisions, however, cast doubt on Plaintiffs' contention that *Arkansas Teacher* modified the scope of *Anderson*'s fraud exception. *See Massey*, 2011 WL 2176479, at *30 n.199 ("If what the Supreme Court intended to do . . . was to . . . create a third category of exception to the general rule articulated in *Lewis v. Anderson*, such intent is not obvious from a plain reading of [*Arkansas Teacher*]."); *Bear Stearns*, 2011 WL 4063685, at *2 ("*Arkansas Teacher* does not expand the scope of the fraud exception."). Further, neither decision reached—much less decided—whether the fraud exception had been satisfied on the facts of this case. *See Massey,* 2011 WL 2176479, at *30 n.199 (observing that *Arkansas Teacher* could "be read as saying that the objector could have, but failed to mount, a viable direct challenge to the merger" and "declin[ing] the plaintiffs' invitation for this court to give hasty, emergency final rulings on such issues"); *Bear Stearns*, 2011 WL 4063685, at *4 (denying motion for reconsidera-

---

coverup of wrongful acts of management," a court of equity would protect the rights of the "innocent shareholder." Br. at 14, 16 (quoting 262 A.2d 246, 249 (Del. 1970)). But Plaintiffs misconstrue *Bokat*. *Bokat* did not hold that the fraud exception is triggered when a merger is used to "cover up" prior acts of mismanagement but rather affirmed the dismissal of the plaintiff's derivative claims. 262 A.2d at 249. Indeed, *Bokat* held that only a ***direct*** claim could be pleaded under such circumstances, as this Court explained: "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." *Id.*

tion because it was clear that the operative legal standard had not changed and declining to rule definitively on *Arkansas Teacher*'s *dicta*).

(b) This Court's Citations To *Braasch* Confirm That Its *Dicta* About "Inseparable Fraud" Referred To Direct Claims.

In its *dicta* stating that "Delaware law recognizes a single, inseparable fraud," this Court cited *Braasch v. Goldschmidt*, 199 A.2d at 764. *Braasch* involved the acquisition of American Sumatra Tobacco Corporation ("American Sumatra") by its majority shareholder, in which the shareholder acquired over 90 percent of American Sumatra's shares through a tender offer and then used a statutory short-form merger to complete the acquisition. *Id.* at 762. The plaintiffs alleged fraud in connection with the tender offer—*i.e.*, that the majority shareholder had "coerced the public stockholders into selling their shares pursuant to the offer to buy upon false, deceptive and misleading statements made in the public press and in official documents." *Id.* at 763. But the plaintiffs "d[id] not challenge the regularity of the merger proceedings" themselves. *Id.*

On those facts, the Chancery Court dismissed the plaintiffs' derivative claims, holding that "the derivative rights asserted passed to the surviving corporation" and the standing of the former shareholders of the acquired corporation to pursue derivative claims was thereby extinguished by the merger. *Id.* at 767. In contrast, the Chancery Court allowed certain of the plaintiffs' direct post-merger claims to proceed, finding that the plaintiffs had effectively alleged "that the merger was the final step of a conspiracy to accomplish an

unlawful end by unlawful means." *Id.* at 764. The Chancery Court explained that, even if "the end was not, in and by itself, unlawful, if the means employed to accomplish that end were unlawful, the whole might be so tainted with illegality as to require invalidation of the merger." *Id.* Cited in both *Anderson* and *Arkansas Teacher*, this decision supports the conclusion that where pre-merger fraudulent conduct makes a merger inevitable, that conduct gives rise to a direct claim that can survive the merger, but not a derivative claim.

Indeed, in *Arkansas Teacher* this Court was careful to cite to (1) the portion of *Braasch* discussing the survival of *direct* claims when addressing the direct claims that Plaintiffs here could have brought (but did not), and (2) the portion of *Braasch* discussing loss of derivative standing when discussing Plaintiffs' *derivative* claims. Thus, when addressing the continuous ownership rule, this Court cited page 767 of *Braasch*, which addresses the *derivative* claims that the Chancery Court had dismissed. *See Arkansas Teacher*, 996 A.2d at 323 n.1 (citing *Braasch*, 199 A.2d at 767). In contrast, in its discussion of "inseparable fraud," this Court cited the portion of *Braasch* (at page 764) addressing the *direct* claims that the Chancery Court sustained. *See Arkansas Teacher*, 996 A.2d at 323 & n.3 (citing *Braasch*, 199 A.2d at 764). *Arkansas Teacher*'s citations to these two distinct portions of *Braasch* make clear that this Court's *dicta* about "inseparable fraud" referred to direct, not derivative, claims.

(c) This Court's *Dicta* About "Inseparable Fraud" Describes A Direct Claim Under *Tooley*.

This Court's *dicta* about "inseparable fraud" is consistent with the framework for distinguishing between direct and derivative claims

adopted in *Tooley*, 845 A.2d at 1035. In *Tooley*, this Court held that whether a claim is direct or derivative turns "*solely* on the following questions: [1] [w]ho suffered the alleged harm—the corporation or the suing stockholder individually—and [2] who would receive the benefit of the recovery or other remedy?" *Id.* (emphasis added). In *Arkansas Teacher*, this Court observed that any injury flowing from the "inseparable fraud" would be suffered by the shareholders rather than the corporation and any recovery would go to the shareholders rather than the corporation: "If the Vice Chancellor had found that [Plaintiffs] had successfully pleaded [their] fraud claim, then [Plaintiffs]—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***." 996 A.2d at 323-24 (emphases added). As this Court's plain language makes clear, any "inseparable fraud" claim would be direct.

Indeed, the "inseparable fraud" claim discussed in *Arkansas Teacher* falls squarely within a line of cases in which this Court and the Chancery Court have held that pre-merger breaches of fiduciary duty that taint a merger give rise to direct—not derivative—claims. *See, e.g.*, *Parnes v. Bally Entm't Corp.*, 722 A.2d 1243, 1245 (Del. 1999) (allegations of "breaches of fiduciary duty resulting in unfair dealing and/or unfair price" give rise to "a direct claim with respect to a merger"); *N.J. Carpenters Pension Fund v. infoGROUP, Inc.*, 2011 WL 4825888, at *2-4, *12 (Del. Ch. Oct. 6, 2011) (allegations of "rogue activities" by the controlling shareholder resulting in a merger at an unfair price give rise to a direct claim); *Dieterich v. Har-*

rer, 857 A.2d 1017, 1028 (Del. Ch. 2004) (allegations of pre-merger misconduct that "was an integral part of and unfairly infected the final merger negotiations" and "unfairly caused a reduction in the price" give rise to a direct claim); *Braasch*, 199 A.2d at 763-64. In each of these cases recognizing a direct claim, the pre-merger misconduct was deemed to be an inseparable part of the merger, thereby "tainting" or "infecting" an otherwise valid merger.[8]

Even though this Court in *Arkansas Teacher* stated that the shareholders would receive directly the benefit of any "inseparable fraud" claim, Plaintiffs nevertheless argue that the Court was referring to a derivative claim in which shareholders could recover damages on a "pass through" basis. Br. at 23. Plaintiffs, however, do not and cannot cite a single Delaware case that has authorized any such "pass through" remedy. Moreover, this Court's *dicta* in *Arkansas Teacher* is inconsistent with Plaintiffs' "pass through" theory. This Court stated that, if Plaintiffs had successfully pled an "inseparable fraud" claim, "the injured parties would be the shareholders who would have post-merger standing to recover damages ***instead of the corporation***," 996 A.2d at 324 (emphasis added), ***not through the corporation itself***.

[8] Plaintiffs cite *Feldman* for the proposition that a claim is derivative "'[w]here all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock.'" Br. at 23 n.6 (quoting *Feldman*, 951 A.2d at 733). That misreads *Feldman*. *Feldman* is one of this Court's many decisions holding that *Anderson*'s fraud exception applies only when the sole purpose of a merger is to extinguish shareholders' derivative standing. *See supra* at 11. *Feldman* did not involve pre-merger conduct that allegedly tainted the merger and rendered it unfair, but rather the issuance of dilutive stock options more than one year before the merger. 951 A.2d at 729-30. Unlike the derivative claim in *Feldman*, any "inseparable fraud" claim by definition relates to the fairness of the merger itself and would therefore be direct.

Unable to cite a single Delaware case recognizing their "pass through" theory, Plaintiffs cite only one case in which a "pass through" remedy was awarded, the hoary Second Circuit decision in *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955). As Plaintiffs well know, this Court has rejected *Perlman*. *See Bokat*, 262 A.2d at 250 ("*Perlman v. Feldmann*, . . . if it holds that stockholders in a derivative action are entitled to recover in their own right, is not persuasive, for ***such is not the law of Delaware***.") (emphasis added). And *Tooley* makes clear that *Perlman* is still "not the law of Delaware." The other cases cited by Plaintiffs were neither issued by a Delaware court nor decided under Delaware law, and merely noted the theoretical possibility of a "pass through" remedy—not one actually awarded such a remedy. *See* Br. at 22 n.5.

4. ***Arkansas Teacher's Dicta* Did Not *Sub Silentio* Abrogate 8 *Del. C.* § 259(a).**

Not only would Plaintiffs' reading of *Arkansas Teacher* mean that this Court in *dicta* overturned *Anderson* and its progeny, but it also would mean that this Court *sub silentio* invalidated Delaware statutory law as well. That is because *Anderson* and its progeny are rooted in the provisions of the General Corporation law. Under 8 *Del. C.* § 259(a), "all property, rights, privileges, powers and franchises, and all and every other interest" of a corporation merged into another corporation belong to the surviving corporation. As the result of a merger, "the derivative claim—originally belonging to the acquired corporation—is transferred to and becomes an asset of the acquiring corporation ***as a matter of statutory law***." *Lambrecht*, 3 A.3d at 284 (emphasis added) (citing 8 *Del. C.* § 259); *accord Anderson*, 477 A.2d

at 1044 (it is "clear under § 259(a) that plaintiff's derivative claim constituted a chose in action which became 'vested' in [the acquirer]"); *Ward*, 852 A.2d at 902 (same).

If adopted, Plaintiffs' reading of *Arkansas Teacher*'s *dicta* would eviscerate § 259(a). According to Plaintiffs, the *Arkansas Teacher* Court announced a rule whereby the acquired corporation's former shareholders maintain post-merger standing to bring derivative claims on behalf of the acquired corporation with any recovery going to those shareholders instead of the acquiring corporation whenever they allege the merger resulted from "inseparable fraud." By transforming derivative claims that were assets of the acquired corporation into assets not of the acquiring corporation but of the acquired corporation's former shareholders, Plaintiffs' reading of *Arkansas Teacher* ignores and nullifies § 259(a). Of course, this Court announced no such rule in *Arkansas Teacher*. Indeed, just three months after *Arkansas Teacher*, this Court reaffirmed the application of § 259(a) and its own prior decisions: "[B]ecause the claim is now (post merger) the property of the acquiring corporation, that corporation is now ***the only party*** with standing to enforce the claim." *Lambrecht*, 3 A.3d at 284 (emphasis added).

Citing *Bangor Punta Operations, Inc. v. Bangor & Aroostock Railroad Co.*, 417 U.S. 703 (1974), Plaintiffs assert that "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." Br. at 28. But *Bangor Punta* did not hold this, and (not involving a merger) is factu-

ally and legally inapposite. In that case, Bangor Punta Corp. (the owner of a controlling interest in a railroad corporation) sold its shares to the plaintiff investment company (Amoskeag Co.). There was no allegation that the sale price was unfair, or that any fraud had occurred in connection with the sale of the shares. Amoskeag later caused the corporation to sue Bangor Punta for mismanaging the corporation. The Supreme Court held that the suit was barred due to the "settled principle of equity that a shareholder may not complain of acts of corporate mismanagement if he acquired his shares from those who participated or acquiesced in the allegedly wrongful transactions." *Id.* at 710, 712-13. Because it did not involve either a merger or even a derivative suit and is thus "clearly inapposite" in the merger context, *Anderson*, 477 A.2d at 1050, this Court held in *Anderson* that *Bangor Punta* does not bar the transfer of derivative claims against the acquired corporation's management (*i.e.*, Plaintiffs' claims here) to the acquirer, or prevent their assertion in a double derivative suit. *Id.* ("If New Conoco were to proceed against Old Conoco's former management and obtain a recovery, it would not constitute a windfall in the *Bangor Punta* sense."). Tellingly, none of the cases cited by Plaintiffs in which Delaware courts applied the *Bangor Punta* doctrine involved mergers. *See* Br. at 28-29.[9]

[9] Plaintiffs assert that "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." Br. at 30 n.8. Not so. The merger agreement simply preserved the pre-existing indemnification rights under Countrywide's bylaws. As the District Court correctly noted, those rights are "limited by the requirements of Delaware law. Del. Code Ann. tit. 8 § 145(b)." B22 n.25. Moreover, in dismissing dou-

C. Plaintiffs Seek To Create a Broad Fraud Exception That Would Swallow *Anderson*'s Continuous Ownership Rule.

The broad fraud exception to *Anderson*'s continuous ownership rule advocated by Plaintiffs would turn the policy underlying that rule on its head and intrude on the powers of the board of the acquiring corporation following a merger. As this Court has explained, "[t]he purpose of the continuous ownership requirement is to prevent the abuses frequently associated with a derivative suit." *Ala. By-Prods. Corp.*, 657 A.2d at 264 (citing *Anderson*, 477 A.2d at 1046). "[A] shareholder is permitted to intrude upon the authority of the board by means of a derivative suit only because his status as a shareholder provides an interest and incentive to obtain legal redress ***for the benefit of the corporation***. Once the derivative plaintiff ceases to be a stockholder in the corporation on whose behalf the suit was brought, he no longer has a financial interest in any recovery pursued ***for the benefit of the corporation***." *Id.* at 265 (emphases added).

If Plaintiffs' reading of *Arkansas Teacher* were adopted, this policy would be undermined to the extent that shareholders claiming "inseparable fraud" would be permitted to "intrude upon the authority of the board" of the acquiring corporation by pursuing derivative claims not "for the benefit of the corporation," but rather for themselves. *Id.*; *see* Br. at 23, 28. For this reason, "Plaintiff's interpretation of *Arkansas Teacher* is at odds with long-settled Delaware law." *Villari,* 208 Cal. App. 4th at 1485.

---

ble-derivative claims against Countrywide's officers and directors, the California state court held that such indemnification provisions did not prevent BofA's directors from exercising their independent business judgment to pursue the claims. *See* B173-75.

Moreover, Plaintiffs' reading of the fraud exception is antithetical to the principles of certainty, consistency, and predictability that undergird Delaware corporation law. Delaware courts establish corporate standards that allow corporations, directors, managers, and shareholders to anticipate the effects that a business transaction may have on their respective rights and obligations. Those standards are especially important in the merger context: "'With respect to matters intracorporate affecting the internal economy of the corporation, or involving a change in the relationship which the members bear to the corporation, there must be order and certainty . . . . Especially is this true in a merger proceeding. . . .'" *Enstar Corp. v. Senouf*, 535 A.2d 1351, 1356 (Del. 1987) (quoting *Salt Dome Corp. v. Schenck*, 41 A.2d 583, 588-89 (Del. 1945)); *accord 3Com Corp. v. Diamond II Holdings, Inc.*, 2010 WL 2280734, at *5 (Del. Ch. May 31, 2010) ("Delaware has a considerable interest in ensuring that corporate entities seeking a business combination under its laws may expect consistent and predictable treatment when appearing before its Courts.").

As this Court has recognized, "[t]he holding in *Lewis v. Anderson* is settled Delaware law and has been consistently followed" since 1984. *Lambrecht*, 3 A.3d at 288 n.36. Indeed, "[o]ne of the benefits of the 'continuous ownership requirement' is that it is straightforward," *Strategic Asset Management, Inc. v. Nicholson*, 2004 WL 2847875, at *2 (Del. Ch. Nov. 30, 2004), a "mechanistic rule," *Hamilton Partners, L.P. v. Englard*, 11 A.3d 1180, 1203 (Del. Ch. 2010), and a "bright-line" guidepost for participants in corporate mergers and acquisitions. *In re Countrywide Fin. Corp. Deriv. Litig.*, 581 F. Supp.

2d 650, 652 (D. Del. 2008). It is hard to overstate the consequences were Plaintiffs' proposed rewriting of the fraud exception to become the law.

First, Plaintiffs' reading of *Arkansas Teacher* necessarily would mean "adopting an expansion of the fraud exception to the continuous ownership rule that would effectively swallow that rule." *Villari,* 208 Cal. App. 4th at 1485. More specifically, because fraudulent conduct is alleged in many (if not most) derivative cases, it is all too easy for a derivative plaintiff to assert that the merger in question was "necessitated by, and is inseparable from," the alleged pre-merger fraud. This would convert *Anderson*'s continuous ownership rule (and narrow fraud exception) into a highly subjective and often unpredictable inquiry. This, in turn, would create uncertainty for corporations, directors, officers, and shareholders in contrast to the "straightforward," "mechanistic," and "bright-line" requirements to which this Court has adhered since *Anderson*.

Second, Plaintiffs' proposed rewriting of the fraud exception would chill merger transactions. If it were to become the law, corporate directors would have perverse incentives not to engage in mergers that would be in shareholders' best interests. For example, acquiring corporations often retain former management of the acquired corporation to focus on integrating the businesses successfully and building accretive value for the combined entities and the shareholder base. Under Plaintiffs' proposed rewriting of *Anderson*, however, former management could face continuing derivative litigation for alleged pre-merger misconduct that could distract them from the successful inte-

gration of the businesses. This prospect might make the merger unattractive as a business matter. As another example, one of the assets an acquiring corporation obtains is the sole right to prosecute any derivative claims against the acquired corporation's officials. *See* 8 *Del. C.* § 259. Under Plaintiffs' proposed rule, however, the acquiring corporation could never be sure which assets it would be acquiring and whether those assets included pre-existing derivative claims. For these reasons (and many others), the acquiring corporation might choose to walk away from a transaction that it otherwise likely would consummate under current Delaware law because of the clarity and predictability of *Anderson* and the fraud exception.

Plaintiffs argue that maintaining *Anderson*'s narrow fraud exception would create "perverse incentives" for corporate fiduciaries to engage in fraudulent misconduct that so weakens a company financially that "the only solution is to sell it to another company, in which case you can evade liability." Br. at 32. But Plaintiffs do not and cannot show that the fraud exception has created such "perverse incentives" since *Anderson* was decided. Moreover, Plaintiffs ignore the many checks on such "perverse incentives," including private securities actions, SEC enforcement actions, direct shareholder actions for breach of fiduciary duty and "inseparable fraud," and double-derivative actions. *See infra* at 32-35. Indeed, it is Plaintiffs' proposed rewriting of the fraud exception that would create "perverse incentives" by prompting directors of financially challenged corporations facing derivative litigation to take those corporations into bankruptcy rather than explore rescue transactions because of the risk

that former shareholders might otherwise maintain standing to pursue derivative claims against the directors.[10]

Third, Plaintiffs' proposed interpretation of the fraud exception—with its necessary inquiry into the relationship between the alleged misconduct and the financial health and/or future prospects of the company—would inevitably lead to confusion and inconsistency in the case law. Those concerns are not merely academic. Cases that were straightforward under *Anderson* would now be uncertain and, in fact, might well be decided differently. Take, for example, *Braasch*. The plaintiffs there challenged pre-merger conduct but not the merger itself. *See supra* at 19-20. As a result, the Chancery Court dismissed the derivative claims but allowed certain direct claims to proceed. *Id.* Applying Plaintiffs' proposed reading of *Arkansas Teacher* and its supposedly broad fraud exception, *Braasch* might be decided differently. This unpredictability would spread beyond Delaware to courts around the country applying Delaware law to cases involving Delaware corporations, which would lead to many more cases that might now be decided differently. *See, e.g.*, *In re Stillwater Capital Partners Inc. Litig.*, 853 F. Supp. 2d 441, 447, 461 (S.D.N.Y. 2012); *Joe W. & Dorothy Dorsett Brown Found. v. Frazier Healthcare V, L.P.*, 847 F. Supp. 2d 952, 957 (W.D. Tex. 2012); *In re Bear Stearns Cos., Sec., Deriv., & ERISA Litig.*, 763 F. Supp. 2d 423, 445-52, 535-36 (S.D.N.Y.

[10] Under the Bankruptcy Code, shareholders lose standing to pursue derivative claims upon the filing of a bankruptcy petition unless and until authorized by the bankruptcy court. *See, e.g.*, *Police & Fire Ret. Sys. of City of Detroit v. Callen*, 44 A.3d 922, 2012 WL 1594881, at *2 (Del. May 7, 2012) (TABLE); *Thornton v. Bernard Techs., Inc.*, 2009 WL 426179, at *3 (Del. Ch. Feb. 20, 2009).

2011); *In re Merrill Lynch & Co., Sec., Deriv. & ERISA Litig.*, 597 F. Supp. 2d 427, 430 (S.D.N.Y. 2009).

The lack of consistency and predictability caused by Plaintiffs' proposed rewriting of the fraud exception also would lead inevitably to expensive litigation. Settled expectations regarding merger practice would be disrupted, and transaction and litigation costs (not just the fraud exception) would expand significantly. This result is contrary to the policies underlying Delaware corporations law: "The Delaware courts have long asserted that this state has a compelling interest in the efficient and consistent application of its laws governing business entities." *See, e.g.*, *Hamilton Partners*, 11 A.3d at 1217 (internal quotation marks omitted).

D. ***Anderson*'s Continuous Ownership Rule Does Not Leave Countrywide's Former Shareholders Without Remedies.**

Finally, Plaintiffs argue that extinguishing their derivative claims under *Anderson*'s continuous ownership rule and its narrow fraud exception "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." Br. at 31. Plaintiffs' assertion, however, ignores *Anderson* itself. There, the plaintiff argued that standing to sue derivatively survived a merger because "otherwise the cause of action is lost for lack of standing of anyone else to pursue it; and the wrongdoers thereby escape accountability"—leaving former shareholders "without a remedy to redress wrongs." 477 A.2d at 1044. In establishing the continuous ownership rule and the narrow fraud exception, this Court rejected the "plaintiff's policy contention that to permit dismissal of plaintiff's [de-

rivative] suit against former management of [the acquired company] will leave a 'wrong' unremedied." *Id.* at 1050.

Plaintiffs also ignore the fact that former Countrywide shareholders already have availed themselves of other remedies. *First*, former Countrywide shareholders (including one of Plaintiffs here) recovered directly by pursuing a securities class action based on the same factual allegations that Plaintiffs seek to assert derivatively here and received ***a settlement of nearly two-thirds of a billion dollars***. *See* B218-49 (approving a $624 million settlement).[11] Because of the existence of such alternative remedies, the loss of shareholder standing to maintain a derivative action upon a merger is not inequitable. *See, e.g.*, *In re Bear Stearns*, 763 F. Supp. 2d at 539 ("Derivative Plaintiff's contention that denial of his standing will inequitably allow a wrong to go without remedy also ignores the other approaches available to, and being used by, Bear Stearns' former shareholders. . . . The securities laws and other avenues offer adequate remedies better tailored to the circumstances of this dispute.").

Second, former Countrywide shareholders pursued double-derivative claims with respect to Countrywide's alleged pre-merger misconduct. In *Villari*, former Countrywide shareholders brought such claims based on the same factual allegations that Plaintiffs assert here. 208 Cal. App. 4th at 1479. As the California Court of Appeal recognized, "there is no compelling need to justify a broadening of the fraud ex-

[11] An appeal concerning the plan of allocation in that settlement is pending. *See Pappas v. Countrywide Fin. Corp.*, No. 11-55570 (9th Cir. appeal docketed Apr. 5, 2011). In addition, as discussed above, Countrywide's former shareholders received $48 million from a record SEC settlement with certain former Countrywide officers.

ception to the continuous ownership rule" because "plaintiff certainly could have pursued a double derivative claim." *Id.* at 1485.[12] Despite Plaintiffs' assertions to the contrary, Br. at 31-33, leaving the decision about whether to pursue the acquired corporation's claims against former management to the acquiring corporation's board of directors does not result in a wrong without a remedy. *See, e.g., Anderson*, 477 A.2d at 1050. The acquiring corporation's directors have fiduciary duties to manage its assets in a manner that serves the best interests of the shareholders, and their management of litigation "is entitled to the same presumption of good faith as other business decisions taken by a disinterested, independent board." *White v. Panic*, 783 A.2d 543, 552 (Del. 2001). To the extent that Plaintiffs complain about "the failure of the BofA board, post-merger, to enforce the pre-merger claim of its wholly-owned subsidiary," *Lambrecht*, 3 A.3d at 290, the board's decisions could be challenged through a double-derivative action—just as the former Countrywide shareholders did in *Villari*.

Indeed, the *Villari* decision by the California Court of Appeal follows this Court's reaffirmation that Delaware "precedents not only validate but also encourage the bringing of double derivative actions in cases where standing to maintain a standard derivative action is extinguished as a result of an intervening merger." *Lambrecht*, 3 A.3d at 288; *accord Ward*, 852 A.2d at 906 (affirming dismissal for lack of

[12] The *Villari* plaintiffs' double-derivative claims were dismissed for failure adequately to allege demand futility, and those former Countrywide shareholders "abandoned any appeal as to the dismissal of those claims." 208 Cal. App. 4th at 1479; B172-75.

post-merger standing and stating that the "plaintiff did not lack any remedy to pursue her derivative claims . . . plaintiff might have been able to bring a post-merger double derivative suit"). Plaintiffs' argument that they will be left without a remedy unless their reading of *Arkansas Teacher* is adopted, Br. at 27-30, ignores the availability of double-derivative claims under Delaware law. As one of the Chancery Court opinions cited by Plaintiffs concludes (Br. at 32), "*Lambrecht* remedies much of the [alleged] inequity resulting from the standing-based extinction of all stockholder derivative actions that resulted from strict adherence to the legalistic approach taken in *Lewis v. Anderson*." *Hamilton Partners*, 11 A.3d at 1206.

In reality, Plaintiffs seek to rewrite settled Delaware law on the continuous ownership rule as a backdoor attempt to end-run this Court's conclusion in *Arkansas Teacher* that Plaintiffs' direct "inseparable fraud" claims have been barred and released by the judgment entered in the Chancery Court. Plaintiffs could have pursued direct "inseparable fraud" claims, just as they pursued direct "failure-to-value" and "failure-to-preserve" claims. As this Court recognized in *Arkansas Teacher*, if Plaintiffs had successfully pleaded and proved that Countrywide's shareholders had been wronged by pre-merger fraudulent conduct that forced a fire sale of Countrywide, Delaware law would have permitted them to pursue direct claims on which ***they would have received the recovery*** rather than Countrywide or BofA. 996 A.2d at 323-24. But Plaintiffs did not "present this claim to the Vice Chancellor." *Id.* For this very reason, this Court held that "the Vice Chancellor did not abuse his discretion in approving the settle-

ment, despite facts in the complaint suggesting that the Countrywide directors' premerger agreement fraud severely depressed the company's value at the time of BOA's acquisition, and arguably necessitated a fire sale merger." *Id.* at 324. All of Plaintiffs' direct claims, including the "failure-to-value" and "failure-to-preserve" claims that they did assert and any "inseparable fraud" claims that they did not, were released by the settlement agreement as approved by the Chancery Court and affirmed by this Court. Plaintiffs may not seek to resurrect them now by distorting and upending settled Delaware precedent.

CONCLUSION

For the foregoing reasons, the certified question should be answered in the negative. Plaintiffs' derivative claims were extinguished in the merger.

RICHARDS, LAYTON & FINGER, P.A.

/s/ Thomas A. Beck
Thomas A. Beck (#2086)
Richard P. Rollo (#3994)
J. Scott Pritchard (#5654)
One Rodney Square
920 North King Street
Wilmington, DE 19801
(302) 651-7700

Attorneys for Countrywide Financial Corporation

Of Counsel:

Brian E. Pastuszenski
Goodwin Procter LLP
53 State Street
Boston, MA 02109

Daniel Roeser
Goodwin Procter LLP
620 Eighth Avenue
New York, NY 10018

Jason L. Krajcer
Teodora E. Manolova
Goodwin Procter LLP
601 S. Figueroa Street
Los Angeles, CA 90017

Dated: March 18, 2013