EFiled: Apr 05 2013 03:37PM EDT
Filing ID 51557611
Case Number 14,2013

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' REPLY BRIEF

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Dated: April 5, 2013

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INTRODUCTION

At the same time that this Court created the continuous ownership requirement to maintain derivative standing in *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), this Court recognized two exceptions to that requirement. *Id.* at 1047 n. 10. Thus, despite Defendants' rhetoric of describing *Anderson* as an "iron-clad" "bedrock" principle of Delaware law, from its very first breath, *Anderson* always has been subject to equitable exceptions. And, it had to be. For the basis of this judicially created requirement that a plaintiff must "maintain shareholder status throughout the litigation" is "to eliminate abuses associated with a derivative suit." *Id. at* 1046. Equity therefore requires that if the continuous ownership requirement would result in a failure of justice, that requirement must give way. This was made clear in this Court's unanimous *en banc* opinion in *Arkansas Teachers Ret. Sys. v. Caiafa,* 996 A.2d 321 (Del. 2010) (*"Arkansas Teachers*"). In *Arkansas Teachers*, this Court, sitting in equity, recognized 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 fire sale merger necessitated by their own conduct. *See id.* at 323.

Defendants argue that this Court in *Arkansas Teachers* did not mean that the derivative suit survives, but rather that only direct claims survive following a merger. But nowhere in *Arkansas Teachers* did this Court even use the word "direct," and in fact the Court's entire discussion about post-merger standing would make no sense in the context of direct claims because direct claims always survive a merger. Regardless of how the claims are characterized, this Court correctly recognized that in the unique circumstances of this case, equity requires that the former Countrywide shareholder plaintiffs may maintain their lawsuit.

Defendants fixate on labels – whether it be direct versus derivative, or, modification versus clarification versus change in the law. But the reality is whether *Arkansas Teachers* is a modification, clarification, or change in the law of *Anderson* is of no moment. The result should be the same; Plaintiffs should be able to maintain their action. Moreover, whether that surviving action is termed a derivative action with the benefit going to the former shareholders of Countrywide, or converts post-merger into a direct action by force of law, or is termed a new hybrid type of action (*e.g*. "quasi-derivative") also is not germane. Equity requires that the original derivative action go forward for the benefit of the former Countrywide shareholders regardless of what it is called.

Defendants implore that the Court must not have meant what it said in *Arkansas Teachers* because if it did, Delaware corporations would choose to file bankruptcy instead of complete a merger, or flee to incorporate in other jurisdictions. Defendants provide no support for their parade of horribles. This was not simply a fraudulent scheme that damaged a 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 *inevitable* conclusion the ultimate destruction of the Company. These circumstances are particularly rare, and when they exist, an inquiry into whether the merger was sought *solely* to eliminate the directors' liability is beside the point. Under the extreme and unusual facts here – where Countrywide's former officers and directors demonstrated 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" – Delaware law will not allow officers and directors to avoid liability by "cover[ing] massive wrongdoing with an otherwise permissible merger." 996 A.2d at 323-24.

Plaintiffs therefore ask this Court to respond to the question posed by the Ninth Circuit in the affirmative; that Plaintiffs may maintain their 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.

ARGUMENT

A. AN AFFIRMATIVE ANSWER TO THE CERTIFIED QUESTION WILL NOT UNDERMINE DELAWARE LAW

Defendants' basic argument is that the continuous holding rule of *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), represents a "bedrock," "iron-clad" principle of Delaware law, and that to answer the certified question in the affirmative would both undermine this principle and throw Delaware law into chaos. *See* DB at 10-14, 26-31.[1] Defendants are wrong.

Unlike the contemporaneous ownership rule, which has as its basis Section 327 of the Delaware General Corporation Law, the requirement that a shareholder maintain "continuous ownership" of a company's stock for purposes of prosecuting a derivative claim is a creature of common law.[2] Because the continuous ownership requirement is a creation of the Courts, it is well within this Court's authority, indeed its mandate, to interpret and apply that requirement. If the continuous ownership rule itself is a judicial creation, it cannot be said that judicial interpretation of this common law rule would "upend" Delaware law any more than the adoption of the rule did in the first place.

In this vein, the *Anderson* court, rather than declare an "iron-clad" continuous holding requirement, as Defendants would have it,

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[1] All references to "DB at __" are to the Answering Brief of Nominal Defendant-Appellee Countrywide Financial Corp. filed with the Court on March 18, 2013, to which the other Defendants joined.

[2] *See Lambrecht v. O'Neal*, 3 A.3d 277, 284 (Del. 2010) ("The contemporaneous ownership requirement is imposed by statute; while the continuous ownership requirement is a creature of common law.").

instead recognized that where enforcing the continuous holding requirement would result in a failure of justice – namely, when the merger was the subject of fraud - the rule must give way. 477 A.2d at 1047 n.10.

In fact, derivative standing itself represents an equitable departure from ordinary rules of standing. "This Court has recognized that a corporate derivative action is a 'judicially-created'doctrine' and a 'creature of equity' that serves as a 'vehicle to enforce a corporate right.'" *CML V, LLC v. Bax*, 28 A.3d 1037, 1044 (Del. 2011). In *Schoon v. Smith*, 953 A.2d 196, 201 (Del. 2008), this Court explained even though the corporation "is theoretically the only proper party to sue for wrongful dealings" with respect to its property, equity permits stockholders to sue in the corporation's name "for the purpose of preventing injustice where it is apparent that material corporate rights would not otherwise be protected." *Id.* at 201-02 (quotations omitted). Under such circumstances, equity disregards the corporate form to a limited extent, and instead recognizes "the truth that the stockholders are *ultimately* the only beneficiaries; that their rights are really, though indirectly, protected by remedies given to the corporation; and that the final object of suits by the corporation is to maintain the interests of the stockholders."[3]

[3] *Id.* at 201 n.10; *id.* at 201 ("equitable standing of a stockholder … [is] grounded upon the interests of justice").

As an equitable tool, the derivative action may also be modified "to meet new exigencies" where legal remedies are inadequate to remedy injustice.[4] For example, derivative standing may be extended to creditors of insolvent corporations, out of recognition that for such corporations, it is the creditors, and not the shareholders, who are the "principal constituency" and who are harmed by any fiduciary breaches.[5]

To be sure, as the court recognized in *Hamilton Partners, L.P. v. Englard*, 11 A.3d 1180 (Del. Ch. 2010), the continuous holding rule for derivative standing may mean that some breaches of fiduciary duty go unremedied.[6] Yet even if such a result is tolerated for ordinary fiduciary breaches in order to benefit the surviving corporation, the *Anderson* court concluded that this result was intolerable in the face of a merger that was the result of actual fraud by a corporation's fiduciaries.

That policy judgment extends to the facts of this case. Defendants here used their fiduciary positions of trust and confidence

[4] *Schoon,* 953 A.2d at 206 (quoting 1 STORY'S EQUITY JURISPRUDENCE 45 (Isaac F. Redfield, ed., 9th ed. 1866)); *see id.* at 204 ("the Chancellor always has had, and always must have, a certain power and freedom of action, not possessed by the courts of law, of adapting the doctrines which he administers. He can extend those doctrines to new relations, and shape his remedies to new circumstances." (quoting 1 POMEROY'S EQUITY JURISPRUDENCE § 60, at 77-78 (5th ed. 1941))).

[5] *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101-02 (Del. 2007).

[6] *See id.* at 1206 ("a rule that forecloses some number of both meritorious and meritless derivative actions will … inherently transfer some degree of wealth from corporations to the individuals who commit corporate wrongs") (citation omitted).

to convert Countrywide into a glorified Ponzi scheme, fundamentally shifting its business model from ordinary lending to predatory, high-risk loans that allowed for quick paper gains but were highly unlikely to be repaid. Defendants then took advantage of the damage they had wrought by reaping hundreds of millions of dollars through insider selling, even going so far as to force Countrywide to buy back its own shares at inflated prices. As a direct – and, indeed, inevitable – consequence of Defendants' misconduct, Countrywide's value was decimated, and shareholders were forced to accept a merger with Bank of America in order to salvage any portion of their investment. Defendants have not reimbursed shareholders for the losses they caused; even the securities class action settlement, discussed below, did not include *any* payments by Mozilo or the other officers and directors.

If "the final object of equity is to do right and justice," *Schoon*, 953 A.2d at 205, shareholders must be permitted to maintain standing to pursue the claims asserted in the underlying litigation. Thus, regardless of how Defendants (mis)characterize this Court's decision in *Arkansas Teachers*, the Court's application of equitable principles to the judicially-created requirements for maintaining standing in order to "meet new exigencies" under the unique facts of this case represents nothing more than the Court's exercise of its inherent equitable powers. *Schoon*, 953 A.2d at 206.

Contrary to Defendants' argument, Plaintiffs do not seek a dramatic change in existing law. Rather, this Court observed in *Arkansas Teachers* that Defendants perpetrated "a single, inseparable fraud" that pervaded and destroyed a company, culminating in a merger that was both necessary and inevitable. *Arkansas Teachers*, 996 A.2d at 323. This is an exceedingly narrow and rare set of circumstances, and Defendants provide no reason to believe that it would have any actual impact on a significant number of cases.[7] Nor have Defendants provided any reason to believe that the potential continuation of derivative claims here would have any actual effect on the decision making of corporate actors. DB at 28-29. Indeed, Defendants' argument is nonsensical on its face: they insist that corporate officers would choose bankruptcy rather than risk subjecting themselves to derivative claims after a merger. DB at 29-30. But in a bankruptcy, the claims against the officer and director defendants become claims of the estate to be prosecuted by the trustee, and defendants do not escape liability.[8]

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[7] Though Defendants cite several cases which, they claim, would potentially be decided differently if the fraud exception is deemed to apply in this case, DB at 30, the opinions they cite either do not consider post-merger derivative standing, or do not involve allegations that the corporation's entire business model had been transformed to facilitate a fraudulent scheme. Moreover, the *Bear Stearns* court agreed with Plaintiffs that *Arkansas Teachers* held that the facts of Countrywide satisfied the fraud exception, and yet still held that *Arkansas Teachers* did not constitute a change in existing law that merited reconsideration of its earlier decision that derivative standing was lost in the merger. *In re Bear Stearns Cos., Inc. Sec., Derivative, & ERISA Litig.*, 2011 WL 4063685, at *3-4 (S.D.N.Y. Sept. 13, 2011).

[8] See, e.g., *In re LandAmerica Financial Group, Inc.*, No. 08-35994 (Bankr. E.D. Va. July 9, 2012) (ECF No. 5096) (derivative claims pursued to settlement after bankruptcy); *In re Luminent Mortgage Capital, Inc.*, No. 08-21389 (Bankr. D. Md. July 2, 2009) (ECF No. 605) (same). *Shandler v. DLJ Merchant Banking, Inc.*, 2010 WL 2929654, *7 (Del. Ch. 2010 July 26, 2010) denying motion to dismiss claims brought by trustee of liquidating trust established under Chapter 11

B. JUSTICE REQUIRES THAT THE ACTION CONTINUES FOR COUNTRYWIDE'S FORMER SHAREHOLDERS

Much of Defendants' arguments have focused on trying to convince this Court that what this Court meant in *Arkansas Teachers* was not that the claims survive the merger (as *Arkansas Teachers* says), but that only direct claims, as opposed to derivative claims, survive the merger. However, nowhere in *Arkansas Teachers* did this Court even use the word "direct." In fact, the entire discussion about post-merger standing does not make sense in the context of direct claims because direct claims always survive a merger.[9]

But whether or not this Court dictates the appropriate verbiage going forward of what to call the continuation of a derivative suit post-merger based on an exception to *Anderson* does not matter.[10] What

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bankruptcy plan against former controlling shareholders of debtor for breach of fiduciary duty, and observing: "For present purposes, what is important is that the Creditor Trustee, as successor-in-interest to Insilco [the debtor], had the right to bring any causes of action belonging to Insilco.")

[9] Defendants place great weight on the fact that *Braasch v. Goldschmidt*, 199 A.2d 760 (Del. Ch. 1964), rejected derivative claims while allowing direct claims to proceed, and from there, reason that *Arkansas Teachers*' cites to *Braasch* must indicate that this Court, as well, intended to reject the derivative claims while permitting direct ones. DB at 20. But as Plaintiffs pointed out – and as Defendants concede, DB at 17-18 n.7 - *Bokat*, which was the *foundational case* for the fraud exception, *also* rejected derivative claims while permitting direct ones to proceed. *See Bokat v. Getty Oil Co.*, 262 A.2d 246, 249 (Del. 1970). Nonetheless, *Bokat*'s holding – that a "Court of Equity" will "protect the innocent stockholder victim" for mergers that are used to cover-up management frauds, *id.* – has been repeatedly cited as the basis for permitting derivative claims to survive a merger in the face of fraudulent manager conduct. *See Anderson*, 477 A.2d at 1046 n.10; *Kramer v. Western Pac. Indus., Inc.*, 546 A.2d 348, 354 (Del. 1988); *Feldman v. Cutaia*, 951 A.2d 727, 731 n.20 (Del. 2008).

[10] While the result would be a continuation of the pre-merger derivative lawsuit, the post-merger action could be called: 1)

matters is that this Court has expressed its concern that the circumstances presented in the underlying action should not go unaddressed, and Mozilo and his cohorts should not be allowed to evade accountability simply because their fraudulent conduct caused Countrywide to be merged out of existence.[11] *Arkansas Teachers* plainly reflects the Court's intention to provide Plaintiffs their day in Court to seek relief from the damage that resulted from Countrywide's directors' and officers' intentional fraudulent acts. Equity demands, under those circumstances, that Plaintiffs' action continues, and *Arkansas Teachers* expressed a way to achieve that.

1. A Pro Rata Form of Recovery Does Not Prevent Post-Merger Derivative Standing

Defendants, citing *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), argue that a derivative action must be for the benefit of the company, and that because Plaintiffs seek a recovery on behalf of the former shareholders, the action must be direct. They continue that derivative claims cannot survive the loss of ownership, and that direct claims have been released so Plaintiffs can never have their day in Court. DB at 22. But this Court must

derivative, with the benefits going to the former Countrywide shareholders; 2) direct, by force of law converting the former derivative lawsuit to a direct one post-merger (so that it would not be released by the pre-merger settlement of a lawsuit challenging the merger); or 3) quasi-derivative (or any other new found name) to distinguish it from a traditional derivative action in which the benefits go to the company.

[11] *See Agostino v. Hicks*, 845 A.2d 1110, 1125 (Del. Ch. 2004) ("Equity's appropriate focus should be the alleged wrong, *not the nature of the claim which is no more than a vehicle for reaching the remedy for the wrong…*" (quoting *Fisher v. Fisher*, 1999 WL 1032768, at *4 (Del. Ch. Nov. 4, 1999)).

have intended that in cases involving the fraud exception, recoveries would go to the original shareholders, because this Court repeatedly has held that the fraud exception applies even for cash-out mergers. S*ee Anderson*, 477 A.2d at 1042; *Kramer*, 546 A.2d at 349, 354. Without *pro rata* recovery going to the former shareholders, the exception to the continuous ownership rule would be pointless.

Moreover, this Court acknowledged in *Tooley* that it is the first question – "Who suffered the alleged harm" – that is critical for distinguishing direct from derivative claims, while the second question – "Who would receive the benefit of the recovery or other remedy" – ordinarily follows from the first.[12] For example, in *In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 766 (Del. 2006), this Court was called upon to decide whether the plaintiffs' claims were direct or derivative. In so doing, this Court not only distinguished the question of who was harmed from the separate question of what the appropriate remedy would be, but went on to *criticize* the plaintiffs for "conflat[ing] three different issues": whether their claims were direct, whether they were entitled to damages, and how those damages would be measured.[13] Ultimately, this Court held that *no* damages were due at all – demonstrating that though

[12] *See Tooley*, 845 A.2d at 1036 ("We believe that this approach is helpful in analyzing the first prong of the analysis: what person or entity has suffered the alleged harm? *The second prong of the analysis should logically follow*." (emphasis added)).

[13] *Id.* at 772; *see id.* at 772 ("where it is claimed that a duty of disclosure violation impaired the stockholders' right to cast an informed vote, that claim is direct. *But that proposition leaves unanswered the second question: what relief flows from the disclosure violation*?" (emphasis added)).

the right to an individualized remedy may have some bearing on the question whether a claim is direct or derivative, it is not dispositive.[14]

Here, Plaintiffs bring claims for, among other things, breach of fiduciary duty, corporate mismanagement, and waste which decimated the value of Countrywide's shares.[15] "[A] claim alleging corporate mismanagement, and a resulting drop in the value of the company's stock, is a classic derivative claim." *Parnes v. Bally Entm't Corp.,* 722 A.2d 1243, 1245 (Del. 1999) (citing *Kramer*, 546 A.2d at 354).[16] Moreover, in *Arkansas Teachers*, just after highlighting that it did not have the "proper vehicle" for determining whether the requirements

[14] *See also Feldman*, 951 A.2d at 733 ("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*."). Defendants argue that *Feldman* did not involve pre-merger fraudulent conduct that "tainted" the merger itself. DB at 22 n.8. This is beside the point; *Feldman* makes clear that the remedy *does not* dictate the nature of the claim.

[15] Defendants do not explain the relevance, if any, of a brief filed by only one of the Plaintiffs, by only one of the Plaintiffs' counsel involved in this appeal, in an unrelated matter, and that was ultimately rejected by the Court of Chancery. *In re Barnes & Noble S'holder Deriv. Litig.*, C.A. No. 4813-VCS, TRANSCRIPT (Del. Ch. Dec. 23, 2010). (Attached hereto as Exhibit A)

[16] As Defendants themselves point out, in some situations, the former officers and directors of an acquired company will remain as managers in the surviving entity. DB at 28. To allow them to share in any recovery for their own misdeeds would be the height of injustice – precisely the opposite of what equity seeks to achieve. *Cf. Hicks*, 845 A.2d at 1125 ("[S]hould the directors be entitled to recover damages for the economic injury they inflicted on themselves as stockholders? If the answer is no because of the fact that they created the harm, this factor would support awarding relief to the class of innocent stockholders, not the corporation."(quoting *In re Gaylord Container Corp. S'holders Litig.*, 747 A.2d 71, 80 (Del. Ch. 1999)).

for the fraud exception were met, the Court noted that had such a claim been presented, "TRS - rather than Countrywide - could recover from the former Countrywide directors," 996 A.2d at 323-24, making clear that *Arkansas Teachers* held that *pro rata* recoveries would be appropriate for the surviving claims.[17]

In the exceedingly rare situation where derivative claims survive a merger, it is the original shareholders – not the surviving company – that suffered the harm of the fraud. That is particularly true here, where the derivative claims were not valued in the merger, and Countrywide shareholders received no payment for them. Under such circumstances, to allow recoveries to go to BofA would provide BofA with a windfall. In fact, those BofA shareholders who did not hold Countrywide stock may have actually *benefited* from the misconduct Plaintiffs challenge, because Defendants' fraud permitted BofA to acquire Countrywide for a cheaper price than the Company would have commanded absent the fraud.[18] To permit them to recover against

[17] Defendants argue that *pro rata* derivative recoveries are "not the law of Delaware," citing *Bokat*. DB at 23. But *Bokat* – despite *rejecting* post-merger derivative claims alleging fraud – is cited today to *permit* such claims, and thus cannot be taken as authoritative on the appropriate remedies for such claims. Moreover, the case that *Bokat* rejected - *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955) – did not involve any allegations of fraud. *See* 219 F.2d at 176.

[18] The fact that *Bangor Punta Operations, Inc. v. Bangor & Aroostock Railroad Co.*, 417 U.S. 703 (1974) and the Delaware decisions applying *Bangor* (Plaintiffs' Opening Brief at 29-30) did not involve a merger is irrelevant. DB at 24-25. As between the acquirer, that gets to purchase a company at a price dragged to rock bottom by insiders' fraud and malfeasance, and the innocent shareholders of that company which will disappear in the merger, equity mandates that the former shareholders recover the damages for the harm wrought by the former insiders, for it is the shareholders who suffered actual economic

Defendants – thus diluting the recovery of the plaintiffs who actually suffered the harm – would not serve equity's purpose of avoiding injustice.

Moreover, this is not a merger that was freely chosen: Defendants functionally forced the shareholders' hand by damaging Countrywide so badly that a merger – and this particular merger – was the shareholders' only viable option. Thus, this is not an ordinary merger situation where the shareholders freely elect to tie their fortunes to another company; it would therefore be deeply unfair if the merger were used as an excuse to further dilute the wealth of Countrywide's shareholders.

2. Answering The Certified Question In The Affirmative Will Not Abrogate Section 259(a)

Defendants argue that if derivative claims are permitted to survive a merger, it would abrogate 8 *Del. C.* § 259(a). DB at 23. This is a red herring. First, as noted above, the continuous holding rule is a creation of common law, not statute. *See Lambrecht*, 3 A.3d at 284. Moreover, in *Anderson* itself, long before *Arkansas Teachers,* this Court recognized an exception to the continuous holding rule where a merger is sought for the purpose of eliminating derivative standing. *Anderson*, 477 A.2d at 1047 n.10. This Court also acknowledged that the exception would apply even for cash-out mergers,

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injury, having had no option but to tender their shares for a depressed sale price. The equitable principles underlying *Bangor* and its progeny would preclude the unharmed acquirer from attaining the windfall from such a recovery particularly where, as here, the acquiring corporation does not compensate shareholders for the value of derivative claims.

suggesting that recoveries would go to the individual shareholders. *Anderson*, 477 A.2d at 1042; *Kramer*, 546 A.2d at 349, 354. Thus, since the first moment that *Anderson* became law, Section 259(a) has co-existed with the fraud exception. *Arkansas Teachers* did nothing more than explain the scope of that exception. Defendants cite no cases – because none exist – where a court held that the rights of a buyer of a corporation under Section 259(a) trump the equitable rights of the corporation's former shareholders to seek to hold former fiduciaries accountable for their egregious, fraudulent conduct that necessitated the merger.[19]

C. THE THEORETICAL ALTERNATIVE ACTIONS PROPOSED BY DEFENDANTS WOULD NOT ADEQUATELY PROTECT PLAINTIFFS

1. Plaintiffs Could Not Have Filed Their Fraud Claims as Direct Challenges to the Merger

Defendants insist that Plaintiffs should have filed direct claims challenging the merger as fraudulent. DB at 34. Defendants are simply incorrect. As all of the cases cited by Defendants confirm, direct claims challenging a merger are permissible *only* when the plaintiffs claim that the merger consideration, and/or the process by which the merger agreement was reached, was unfair.[20]

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[19] *Lambrecht* (DB at 24) is not relevant to the analysis of Section 259(a)'s application because the Court did not have before it the factual scenario at bar: fraud and misconduct by insiders and board members that was of such an egregious nature that it causes the ruin of the company, necessitating that it be sold at a fire sale price.

[20] *See Parnes*, 722 A.2d at 1245 ("In order to state a direct claim with respect to a merger, a stockholder must challenge the validity of the merger itself, usually by charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price."); *N.J. Carpenters Pension Fund v. infoGROUP, Inc.*, 2011 WL 4825888, at *12 (Del. Ch. Oct. 6, 2011) (claims deemed to be direct because the

Here, Plaintiffs do not allege that the merger consideration or the process by which the merger was negotiated was unfair, because by the time of the merger, Countrywide's value already had been destroyed. It is for this reason that the Vice Chancellor suggested that the merger consideration was the best that shareholders could reasonably have hoped for.[21] Thus, a direct challenge to the merger was unavailable to Plaintiffs.

Defendants are also wrong to argue that *Braasch* would have permitted the claims alleged here to be brought directly. DB at 21. In *Braasch*, the plaintiffs alleged that the merger itself was the object of a fraudulent conspiracy to allow the defendants to seize control of the target corporation. *Braasch*, 199 A.2d at 762-763. Under such circumstances, and based solely on the pleadings, the court held that it would be premature to dismiss the claim that the defendants used unlawful means to achieve a goal that – viewed extremely narrowly – was not in itself unlawful. *Id.* at 764. Here, Plaintiffs do not allege that a merger was the object of an illegal conspiracy; thus, they could not have brought their claims directly under the rule announced in *Braasch*.

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plaintiffs challenged the process by which the merger was negotiated); *Dieterich v. Harrer*, 857 A.2d 1017, 1029 (Del. Ch. 2004) (sustaining direct claims because plaintiffs had, for pleading purposes, sufficiently alleged unfair dealing).

[21] *In re Countrywide Corp. S'holders Litig.*, 2009 WL 846019, at *8 (Del. Ch. Mar. 31, 2009) ("There is no suggestion that any entity other than BOA was interested in (or capable of) acquiring Countrywide. In addition, there is no reason to believe that a longer period to search for an acquirer - if indeed Countrywide could have survived such longer period - would have been fruitful. In the absence of an acquisition, the fate of Countrywide might well have been bleak.").

2. Double Derivative Remedies Are Not Sufficient

The theoretical availability of a recovery via a double derivative action is inadequate to compensate Countrywide's former shareholders for the harm the Company suffered as a result of Defendants' fraud. As an initial matter, BofA has taken no steps to initiate a derivative action for the harm done to Countrywide in the more than *four and a half years* that have passed since the closing of the Merger, belying the notion that such an action will ever be brought. Indeed, numerous courts have recognized that a lawsuit by the acquiring corporation – even if it does not run afoul of the *Bangor Punta* doctrine – is exceedingly unlikely.[22] Among other things, managers who commit fraud will rarely sell to a corporation that they expect will pursue derivative claims against them.[23]

Further, though double derivative actions may be effective in situations where the directors of acquiring corporation participated in the original fraud (thus demonstrating a lack of independence and demand futility at the parent level), *see Hamilton*, 11 A.3d at 1208, in other situations, courts generally will defer to the acquirer's business judgment that a derivative lawsuit is not in the acquiring corporation's best interests.[24] Thus, "[w]hile the courts may indulge

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[22] *See, e.g.*, *Carsanaro v. Bloodhound Techs., Inc*., 2013 Del. Ch. LEXIS 69, 110 (Del. Ch. Mar. 15, 2013); *Golaine v. Edwards*, 1999 Del. Ch. LEXIS 237, at *15 (Del. Ch. Dec. 21, 1999).

[23] *See Carsanaro*, 2013 Del. Ch. LEXIS 69, at *110 ("For companies who regularly make acquisitions, a reputation for pursuing claims against sell-side fiduciaries would not help their business model.").

[24] *See, e.g., Penn Mart Realty Co. v. Perelman*, 1987 Del. Ch. LEXIS 424, at *7 (Del. Ch. Apr. 15, 1987) ("I agree that it is highly unlikely

the notion that the [derivative] claims still 'survive' [a merger] ... they usually die as a matter of fact." *Golaine*, 1999 Del. Ch. LEXIS 237, at *15; *see also Carsanaro*, 2013 Del. Ch. LEXIS 69, at *110 (same). Given this reality, unless shareholders are permitted to press their derivative suit after the completion of the merger, the original fraud will go *entirely* unremedied, and the "deterrence effects of meritorious derivative suits on faithless conduct" will be lost. *Guttman v. Huang*, 823 A.2d 492, 500 (Del. Ch. 2003).[25]

Finally, as described above, any recovery in a double derivative action would redound to the benefit of all current BofA shareholders, an overwhelming majority of whom were not pre-merger Countrywide shareholders and who therefore cannot even arguably have been harmed by the misconduct Plaintiffs challenge.

3. The Federal Securities Fraud Class Settlement Cannot Substitute For Delaware Corporate Law

Defendants finally argue that the recovery obtained by certain purchasers of Countrywide securities in the federal securities fraud class case sufficiently remedied the wrongdoing. In essence, Defendants argue that this Court should outsource Delaware corporate

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that Pantry Pride, which now controls Revlon, will seek to redress the allegedly excessive severance payments or allegedly excessive fees and therefore those abuses (if they are abuses) are not likely to be addressed.").

[25] Notably, in the very case that established the plaintiffs' right to bring double derivative actions, the court ultimately held that demand was not excused and dismissed the complaint. *See Lambrecht*, 3 A.3d at 279 n.1; *In re Merrill Lynch & Cos., Inc. Sec., Derivative & ERISA Litig.*, 773 F. Supp. 2d 330 (S.D.N.Y. 2011).

law principles to the federal government, by allowing federal securities remedies to take the place of remedies for breaches of fiduciary duty and waste. DB at 32. This argument is wrong and dangerous.

First, it is well-established that the federal securities laws do not provide remedies for governance failures. *See Santa Fe Indus. Inc. v. Green*, 430 U.S. 462 (1977). Federal securities class actions and shareholder derivative actions are designed to remedy fundamentally different wrongs. Thus, contrary to Defendants' argument, Section 10(b) is simply not a replacement for Delaware fiduciary duty law.

Second, only persons who purchased or sold a security have a remedy under Section 10(b). *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 732-33, 737-38 (1975). This leaves *holders* – Countrywide's long-term investors, such as Plaintiffs here – entirely out in the cold, or, at best, only partially compensated.

Third, the federal securities laws are extremely narrow. For example, in Section 10(b) actions, Plaintiffs can only recover against corporate officers who had "ultimate authority" over false statements, thus raising the possibility that no remedies at all will be available against corporate officers who did not speak directly to the market, no matter how egregious their conduct. *See Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). Thus, the federal securities laws are a poor substitute for Delaware corporate governance standards.

Finally, neither Mozilo nor any of the other Countrywide directors or officers paid *anything* in the Countrywide securities class action settlement. Thus, it is particularly disingenuous for Defendants to take the position that the wrong here has been remedied.

Given the obvious differences between federal securities class actions and shareholder derivative actions, the availability of a remedy via the former has no bearing on the inequity of extinguishing the latter.

CONCLUSION

For the foregoing reasons, the certified question should be answered in the affirmative.

Dated: April 5, 2013

Respectfully submitted,

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