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IN THE SUPREME COURT OF THE STATE OF DELAWARE

CITIGROUP INC., CHARLES PRINCE, VIKRAM PANDIT, GARY CRITTENDEN, ROBERT RUBIN, ROBERT DRUSKIN, THOMAS G. MAHERAS, MICHAEL STUART KLEIN, and DAVID C. BUSHNELL, *Defendants Below, Appellants,* v. AHW INVESTMENT PARTHNERSHIP, MFS, INC., and ANGELA H. WILLIAMS, as Trustee of the Angela H. Williams Grantor Retained Annuity Trust UAD March 24, 2006, the Angela Williams Grant Retained Annuity Trust UAD May 9, 2006, the Angela Williams Grantor Retained Annuity Trust AUD November 1, 2007, the Angela Williams Grantor Retained Annuity Trust UAD July 1, 2008, the Angela Williams Grantor Retain Annuity Trust UAD July 1, 2008, and the Angela Williams Grantor Retained Annuity Trust UAD November 21, 2008, *Plaintiffs Below, Appellees.*	No. 641, 2015 Certification of Question of Law from the United States Court of Appeals for the Second Circuit C.A. Nos. 13-4488-cv(L), 13-4504cv(XAP)

BRIEF OF AMICUS CURIAE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF APPELLEES

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Dated: February 25, 2016

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STATEMENT OF INTEREST OF THE AMICUS CURIAE

Public Investors Arbitration Bar Association ("PIABA") is a bar association comprised primarily of attorneys who represent members of the investing public, including a number of state regulators. The mission of PIABA is to promote the interests of, and to help protect the investing public. PIABA also advocates for public education regarding investment fraud and industry misconduct. PIABA regularly issues comment letters regarding FINRA rule changes, provides testimony to government agencies and Congress, and files amicus briefs on a variety of issues pertaining to the protection of the investing public—the very people and businesses who provide corporations with the capital needed to drive economic activity in the United States.

SUMMARY OF THE ARGUMENT

Issuers of securities owe similar disclosure duties to investors looking to buy, sell, or not sell, securities. The remedies such investors have when issuers breach their disclosure duties should also be consistent. It is undisputed that purchasers and sellers of securities have direct claims against an issuer that induces them to rely on its misrepresentations or omissions when deciding to purchase or sell the issuer's securities. There is no reason to treat differently the claims of an investor who decides *not* to sell, rather than to sell, in reliance upon an issuer's misrepresentations or omissions. Indeed, the United States Supreme Court gave strong indicia that holder claims are direct, not derivative, and this Court's established analytical framework to determine whether investor claims are direct or derivative makes clear that holder claims are direct, because the harm falls upon the shareholder, not the corporation, and the harm to the shareholder is caused by the corporation. Viewing holder claims as derivative would produce the absurd result of the corporation suing itself. Treating holder claims as derivative would also produce inconsistent and illogical results when holders sue both primary and secondary actors such as aiders and abettors of the primary wrongdoer's violation. It is undisputed that a holder's claims against secondary actors are direct, not derivative, and the existence of a primary violation against the plaintiff is a necessary element of an aiding and abetting claim against the secondary violator.

ARGUMENT

I. HOLDER CLAIMS SEEK TO REMEDY HARM TO INVESTORS, NOT THE CORPORATION, AND SHOULD THEREFORE BE DIRECT CLAIMS.

A. An Investor's Decision, Induced by Misrepresentations or Omissions, Should Give Rise to the Same Remedy Whether Such Decision Was to Sell, or Not to Sell.

To sell, or *not* to sell: that may be the question, but the remedy available to an investor whose decision is wrongfully induced by corporate misrepresentations or omissions should be the same, regardless of whether that decision is to sell—a "seller's claim"—or not to sell—a "holder's claim."

Courts from across the country, in jurisdictions that allow holder claims, have treated holder claims against corporate actors who, through misrepresentations or omissions induce such holder to abstain from selling their securities, as direct claims. *See, e.g.*, *In re Countrywide Corp. S'holders Litig.*, 2009 Del. Ch. LEXIS 44, at *18-19 (Mar. 31, 2009) ("[a] common law fraud 'holder' claim under *Mercadante* requires [a plaintiff to prove statements] (1) were false and (2) material, and (3) known … to be false at the time of their making and (4) subsequently caused [a plaintiff] (5) justifiable to rely on them to its (6) detriment by holding, instead of selling,"); *Starr Found. v. Am. Intl. Grp., Inc.*, 901 N.Y.S.2d 246, 261-62 (App. Div. 2010); *Small v. Fritz Cos., Inc.*, 65 P.3d 1255, 1264-65 (Cal. 2003) ("Denying a cause of action to persons who hold stock in reliance upon corporate misrepresentations reduces substantially the number of persons who can enforce corporate honesty.”).

It would be inconsistent and hardly logical for a holder of securities to have a direct claim if he decides *to sell* his securities in reliance upon a corporate actor’s misrepresentations or omissions, but a derivative claim if he decides *not to sell* his securities in reliance upon a corporate actor’s misrepresentations or omissions. Both such claims should be treated consistently – and there cannot be any dispute that a securities holder who sells his securities in reliance upon a corporate actor’s misrepresentations or omissions has a direct claim against the corporation.

B. Issuers of Securities Owe Similar Disclosure Duties to Holders as They Do to Purchasers and Sellers, and Breaches of Such Similar Duties Should Trigger Consistent Remedies.

The Securities and Exchange Commission has made clear that issuers of securities owe similar disclosure duties to holders of their securities as they do to buyers and sellers of such securities:

> The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, ***and so long as they hold it***. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, ***or hold*** a particular security.

Securities and Exchange Commission, “The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation,” available at https://www.sec.gov/about/whatwedo.shtml (last visited February 23, 2016) (emphasis added).

Purchasers and sellers of securities can unquestionably bring direct claims under the federal and state securities laws against issuers and certain secondarily liable parties, arising out of material misrepresentations and omissions that induce them to purchase or sell such securities. Since an issuer owes similar disclosure duties to buyers, sellers, *and holders* of securities, it would be inconsistent—and unjustifiably so—for the holders' claims against issuers or secondarily liable parties, arising out of breaches of such duties, to be considered derivative claims while buyers' or sellers' similar claims against the same parties are considered direct claims.

While "holder claims" arising out of misrepresentations or omissions are statutorily excluded under the Securities and Exchange Act of 1934, they continue to be permitted and prosecuted under state law in many jurisdictions, including Florida and New York. *See Continental Ins. Co. v Mercadante*, 225 N.Y.S. 488 (1st Dept. 1927); *Matana v. Merkin*, 989 F.Supp.2d 313 (S.D.N.Y. 2013). More importantly, the rationale for disallowing holder claims under Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j, and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, has nothing to do with the derivative-direct distinction, but rather with the difficulty of proving such claims.

See Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d. Cir. 1952); *see also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). Tellingly, the United States Supreme Court in *Blue Chip Stamps* limited its holding disallowing holder claims to claims brought under Rule 10b-5 and Section 10(b) of the Securities and Exchange Act:

> [I]t has long been established in the ordinary case of deceit that a misrepresentation which leads to a refusal to purchase or to sell is actionable in just the same way as a misrepresentation which leads to the consummation of a purchase or sale.

421 U.S. at 744.

Therefore, while disallowing holder claims in the context of federal securities class actions, the United States Supreme Court clearly regarded such claims as direct, not derivative, just like the direct claims "in the ordinary case of deceit." *Id.*; *see also Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 930 (Tex. 2010) (holder claims involving "a direct communication between the plaintiff and the defendant" are "less like holder claims and more like the 'ordinary case of deceit' described by the U.S. Supreme Court [in *Blue Chip Stamps*]."). This Court should regard holder claims the same way.

C. *Blue Chip Stamps* Strongly Supports that the United States Supreme Court Would Most Likely Rule that Holder Claims Are Direct, Not Derivative.

Blue Chips Stamps' analysis strongly suggests that the United States Supreme Court regards the holder claims as direct, not derivative. First, as shown above, the Supreme Court regarded holder claims, outside of the '34 Act's Section 10(b) and Rule 10b-5 securities class action context, as "actionable in just the same way as" buyer and seller claims. *Blue Chip Stamps*, 421 U.S. at 744.

Second, the Supreme Court explicitly stated that the buyer and seller claims were "nonderivative." *Id.* at 735 ("The principal express nonderivative private civil remedies … for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities."). The Supreme Court would find, using the same analysis, that holder claims are direct.

In further support of this conclusion, the Supreme Court specifically discussed the limited, exceptional circumstances when holder claims may be brought derivatively:

> Three principal classes of potential plaintiffs are presently barred by the *Birnbaum* rule [*barring holder claims*]. First are potential purchasers of shares, either in a new offering or on the Nation's post-distribution trading markets, who allege that they decided not to purchase because of an unduly gloomy representation or the omission of favorable material which made the issuer appear to be a less favorable investment vehicle than it actually was. ***Second are actual shareholders in the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material***. Third are shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5. It has been held that shareholder members of the second and third of these classes may frequently be able to circumvent the Birnbaum limitation through bringing a derivative action on behalf of the corporate issuer ***if the latter is itself a purchaser or seller of securities***.

Blue Chip Stamps, 421 U.S. at 737-38 (emphasis added). Thus, the Supreme Court acknowledged that holder claims may be brought derivatively on behalf of the corporation in the exceptional circumstances when not just the holder, but also *the corporation itself is a purchaser or seller of securities*. Indeed, it is clear from the Supreme Court's comment that what makes a holder's claims derivative in that context is not the holder's *own* securities holdings, but the *corporation's* holdings.

Between the Supreme Court's (1) observation that, outside of the Section 10(b) and Rule 10b-5 context, holder claims are "actionable in just the same way" as buyer and seller claims; (2) observation that buyer and seller claims are "nonderivative"; and (3) acknowledgement that a securities holder's claims may only be brought derivatively when the corporation *itself* is also a buyer or seller of those securities, it is clear that the Supreme Court regards holder claims as direct, not derivative. This Court should similarly hold.

D. Recent Delaware Decisions Support That Misrepresentations and Omissions to Shareholders by an Issuer Necessarily Give Rise to Direct Claims Under Established Delaware Law.

This year, this Court affirmed the holding of *Tooley v. Donaldson, Lufkin & Jenrette*, 845 A.2d 1031 (Del. 2004), stating:

> To answer the question [of whether a claim is direct or derivative] the reviewing court must look to the body of the complaint and consider the nature of the wrong alleged and the relief requested. The plaintiff must demonstrate that 'the duty breached was owed to the [investor] and that he or she can prevail without showing an injury to the [entity].'

Culverhouse v. Paulson & Co., 2016 Del. LEXIS 34 at *8 (Jan. 26, 2016). This Court has also recently stated, while discussing direct claims, that:

> [A] more important initial question has to be answered: does the plaintiff seek to bring a claim belonging to her personally or one belonging to the corporation itself? … Reading *Tooley* to convert direct claims belonging to a plaintiff into something belonging to another party would, we confess, be alien to our understanding of what was at stake in that case, or in the cases after *Tooley* that relied on it.

NAF Holdings, LLC v. Li & Fung (Trading) Ltd., 118 A.3d 175, 180 (Del. 2015).

Holders—investors who decide not to sell their securities in reliance upon a corporate actor's misrepresentations or omissions—bring claims that are unique to them, on behalf of themselves, against an issuer. These claims are direct under the test articulated in *Tooley* and affirmed in *NAF Holdings* and *Culverhouse*. In the instant case – as in the typical holder case – the Plaintiffs' injuries were caused not by Citigroup's decision to make subprime investments, but by Citigroup's alleged fraudulent misrepresentations that induced Plaintiffs to hold Citigroup shares after they had decided to sell them. Citigroup owed its shareholders a duty not to misrepresent its exposure, and breached that duty. Citigroup's *misrepresentations* did not injure Citigroup; Citigroup's *decision to invest in subprime mortgages* injured Citigroup. This case, like all holder cases, involves a direct cause of action under *Culverhouse*.[1]

E. Investors with Holder Claims—Not the Corporation—Have Standing to Recover When the Bad Actor Is Not a Third Party Harming the Corporation, But the Corporation Itself, Harming the Investors.

Where the plaintiff is a securities holder who was fraudulently induced by corporate actors not to sell, he or she holds a different type of claim than those normally asserted in a derivative suit. For instance, in a case where a director commits waste, perhaps by selling corporate assets for an unfairly low price, the bad actor is the director, and the harmed party is the corporation itself, because it became less valuable. *See, e.g. Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000). Similarly, in a lost corporate opportunity case, the corporation again becomes less valuable because a director usurped the corporate opportunity. *See, e.g. Cooke v. Oolie*, 1997 Del. Ch. LEXIS 92, at *45 n.96 (June 23, 1997) ("[U]surpation of corporate opportunity is derivative."). In each of these instances, only the corporation can vindicate these losses—a shareholder cannot pursue her own

[1] Simply because an issuer is a defendant in a case brought by a shareholder of that issuer does not mean the case becomes a derivative action. If it was otherwise, *all* shareholder claims against the issuer would be derivative and this Court would not have bothered to articulate a test for direct shareholder claims against an issuer. Many claims by shareholders against corporations are deemed to be direct claims and shareholder standing is never challenged. As detailed above, one common example is a case brought under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, where an investor alleges that he or she purchased or sold securities in reliance upon the issuer's materially false representations or omissions. In such a case, the claim is plainly direct. The fact that, as here, the corporation may also suffer harm—sometimes, but not necessarily—in connection with such misrepresentations or omissions, ought not change this result.

action outside the derivative form. Notably, such losses arising out of the corporation's diminution in value fall equally – and indirectly, as a consequence of such corporate diminution in value – upon all shareholders. But the facts in these types of derivative cases, where the corporation primarily suffers the harm, are fundamentally different than the facts in a holder case, where specific shareholders who have decided to sell and were induced not to by fraud do not.

To distinguish conceptually between direct and derivative claims, it may be useful to examine the "direction" the harm travels and where it comes to rest. Where the corporation is harmed by waste or loss of opportunity, the harm travels from the *outside in* towards the corporation, and the corporation must look inward at itself to determine the amount of harm and to recover for it. Put another way, the harm always centers on the corporation itself in the form of an injury suffered by the corporation. To recover, the corporation must reverse the direction of the harm and turn toward the direction from whence the harm originated—whether that be from a rogue director or an outside tortfeasor or creditor—to recover. This gives rise to a derivative claim where the party with standing is the corporation itself. By contrast, in a holder case, the harm travels from the *inside out*, as the corporation itself directs the harm outward towards a shareholder. To recover, the holder must reverse the direction of the harm and turn back to the corporation to recover. In this scenario, the holder has standing to pursue his or her direct claim against the corporation.

F. Investors with Holder Claims—Not the Corporation—Have Standing to Recover When the Bad Actor Is a Third Party Aiding and Abetting the Fraud of the Corporation.

The ramifications of this Court's decision will likely extend to investors' efforts to hold culpable third parties, such as aiders and abettors, who may participate in, and may be held liable for, the primary wrongs of the corporation. In a case where corporate actors, or their third-party accomplices, make material misrepresentations or omissions to investors, it would be inconsistent, indeed illogical, to state that investors who rely on such misrepresentations or omissions to purchase or sell the corporate issuer's securities have direct claims, while investors who rely on the same misrepresentations and omissions in order not to sell have derivative claims, notwithstanding that the harm they suffered arose out of the same breach of duties. Claims against secondary wrongdoers are indisputably direct claims—the corporation would be barred by doctrines such as *in pari delicto*—leaving only the shareholders to recover. *See, e.g. Kirschner v. KPMG*, 15 N.Y.3d 446, 464 (2010) ("The doctrine of in pari delicto mandates that courts will not intercede to resolve a dispute between two wrongdoers.").

By way of illustration, consider a case where IssuerBank is aided and abetted in committing a fraud against holders by AuditorCorp, who knowingly participates in IssuerBank's false statements to holders in violation of New York common law. If a holder of IssuerBank securities has direct claims, the holder can proceed against IssuerBank for the fraud, and against AuditorCorp for aiding and abetting if permitted by state tort law. But if the holder's claims were deemed to be derivative, only IssuerBank would have standing to sue itself—an absurd result—and only IssuerBank would have standing to sue AuditorCorp for aiding and abetting IssuerBank's own fraud—a result not only absurd but against public policy and precluded by the doctrine of *in pari delicto*, see *Kirschner*, *supra*. In such a scenario, the investors would be left without redress. Delaware's decision to treat the holder claim as derivative would extinguish the aiding and abetting tort recognized by another state.

Furthermore, the first element of an aiding and abetting claim is the existence of primary liability, *i.e.*, a wrongful act by the primary violator against the same plaintiff. *See, e.g.*, Restatement (Second) of Torts, §876. But in the context of a holder claim, the wrongful act is precisely the misrepresentation or omission by the corporation that results in the holder's decision not to sell. If that misrepresentation was deemed to give rise to a derivative, not direct, claim, the holder would never be able to prove the first element of his or her aiding and abetting claim against the secondary actor, *i.e.*, the fact that the holder has suffered an injury at the hands of the primary violator. The outcomes of such a scenario would be either that the holder's aiding and abetting claim is effectively rendered impossible, or that the claim against the secondary violator is deemed to belong to the primary violator, the corporation—a result that is both against public policy as set forth in the unclean hands doctrine, and absurd given that both wrongdoers acted together to harm a third party, the holder.

G. Strong Policy Reasons Exist to Recognize that Holders Have a Direct Cause of Action.

Strong policy arguments also support deeming holder claims to be direct. First, if holder claims are derivative under the foregoing scenario, a clear moral hazard—where a corporate actor takes a risk because someone else bears that risk—is created. If the corporation is insulated from its own malfeasance by the protections of the derivative suit, its and its corporate actors' incentive to lie to investors to keep them holding its shares is magnified. This may be particularly problematic in the context of opaque investment funds where the investors' only source of information comes directly from the managers and no public filings are made. After all, in every instance of fraud, there is a chance the fraud may never be revealed, and where revelation would lead to trivial or no consequences, the table is set for fraud. Moreover, where the corporation's malfeasance insulates third parties, such as aiders and abettors, those third parties are more likely to participate in a fraud than to abstain, as a result of that same moral hazard.

Second, a shareholder with a holder claim suffers a different *type* of harm than loss of value of the corporation: the shareholder has been harmed by fraudulent statements made by the corporation. This makes that shareholder a different *type* of creditor than a passive shareholder. If that shareholder can prove he was fraudulently induced to hold, he should recover for his different type of injury. This is of no small consequence to investors: when an enterprise becomes unable to pay its bills as they come due, its investors are often left without recourse. But a major difference exists between an investor who held through sheer inertia, and an investor who positively planned to sell out but was fraudulently induced to hold: the company *lied* to push that latter investor to the back of the creditor line. Without that corporate lie, the shareholder would not even be a creditor, because he would have disposed of his shares. That investor is different from passive investors, and should be able to recoup what he can as a result of that lie; by contrast, it is equitable and in line with established bankruptcy law principles that the passive investor who never had plans to sell bear the burden of losing his investment.

Another *amicus* in this case points to *Malone v. Brincat*, 722 A.2d 5 (Del. 1998), as a pre-*Tooley* case where false disclosures injured a corporation. Yet even in *Brincat* the direct-derivative question was decided as Appellees urge in this case:

> Delaware law also protects shareholders who receive false communications from directors even in the absence of a request for shareholder action. When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty. That violation may result in a derivative claim on behalf of the corporation or a [direct] cause of action for damages. There may also be a basis for equitable relief to remedy the violation.

722 A.2d at 14. Thus, this Court has already recognized holder claims can give rise to direct claims; it should not disturb this ruling.

Lastly, deeming holder claims to be derivative would result in Delaware's internal affairs laws impermissibly encroaching upon other states' tort laws protecting their own residents against fraud, an excessive result neither desirable nor intended by the internal affairs doctrine. The internal affairs doctrine

> is a long-standing choice of law principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs, namely the state of incorporation. Only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs. By providing certainty and predictability, the internal affairs doctrine protects the justified expectations of the parties with interests in the corporation.

VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1113 (Del. 2005). But in a holder lawsuit, unlike in a derivative suit where directors and officers are tortfeasors, the corporation itself is the tortfeasor and the directors are not necessarily parties. If such a holder lawsuit was deemed derivative, demand would have to be made. But, where demand is made and the board decides to act, the board's action would yield absurd results that no court would entertain: where the corporation itself is deemed to be both the tortfeasor and the tort victim, it would have to sue itself and recover from itself. Such a lawsuit would have to be captioned, in Kafkaesque fashion, "IssuerCorp v. IssuerCorp."

Such absurd results would also greatly undermine the protection that states afford their residents – and in particular their investors – in tort law against fraud, and raises the question of whether Delaware, where many issuers are incorporated, can nullify the tort law of other states, designed to protect non-Delaware residents for fraud committed against them outside of Delaware, even if such fraud may originate in Delaware. For example, if a Delaware corporation fraudulently induces a Maryland resident to hold shares in Maryland, but the Delaware law governs under the internal affairs doctrine because the suit is deemed to be derivative, the application of Maryland's tort law would be, unjustifiably, avoided. Such troubling overreach is avoided if this Court finds that holder claims are direct. Such a finding would also have a twofold benefit: the internal affairs doctrine remains intact and stable, and holders located in other states have redress under the laws of the states where they were harmed.

CONCLUSION

For all of the foregoing reasons, the Court should answer the certified question by determining that under Delaware law, holder claims such as those plaintiffs attempt to assert are properly brought in a direct action, not a derivative action.

Dated: February 25, 2016

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CERTIFICATE OF SERVICE

I, Thad J. Bracegirdle, hereby certify that on the 25th day of February 2016, the attached **MOTION OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF APPELLEES, BRIEF OF AMICUS CURIAE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF APPELLEES** and **[PROPOSED] ORDER** were served upon the following counsel of record via File & Serve*Xpress*:

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